University of Alberta

THE OPPRESSION REMEDY: The "Reasonable Expectations" Test and the Economic Theory of "Incomplete Contracting"

by

Nancy L. Kortbeek

A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfillment of the requirements for the degree of Master of Laws.

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Edmonton, Alberta

Spring, 1999

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THE OPPRESSION REMEDY: The "Reasonable Expectations" Test and the Economic Theory of "Incomplete Contracting"

ABSTRACT

This thesis examines the application of the statutory oppression remedy in Canada. It reviews the historical backdrop which prompted the enactment of the oppression remedy. As well, it analyses the judicial application of the remedy since its enactment. The American approach to minority shareholder protection is also considered. The thesis' main goal is to more clearly delineate the structure and content of the "reasonable expectations" test, which is currently the governing test for the remedy's application. Economic analysis is used to assist in this endeavor, with specific emphasis on the economic theory of "incomplete contracting."

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THE OPPRESSION REMEDY: The "Reasonable Expectations" Test and the Economic Theory of "Incomplete Contracting"

> **The truth is that a system of law built on what a particular court considers to be the expectations of the parties or what it thinks is fair without engaging in further probing about what it means by this does not bear the hallmark of a rational system of law.***
>
> *Comment by La Forest, J. in *Jensen* v. *Tolofsen* (1994) 120 D.L.R. (4th) 289, [1994] 3 S.C.R. 1022, [1995] 1 W.W.R. 609 at 625. This case was not an oppression remedy case. The statement was made in relation to determining the appropriate choice of law rules for a tort action. Although the case did not involve the oppression remedy, the comment accurately describes a prevalent concern with the current application of the oppression remedy in Canada and thereby reveals the quest of this thesis.

CHAPTER ONE

THE HISTORY OF THE OPPRESSION REMEDY

I. INTRODUCTION

The federal statutory oppression remedy contained within the *Canada Business Corporations Act*,[1] has been described as the "broadest, most comprehensive and most open-ended shareholder remedy in the common law world."[2] The broad wording found within the *CBCA* has since been incorporated into a majority of the provincial statutes in Canada, with minor variations in wording.[3] It is quite conceivable that the enactment of this remedy constitutes one of the most important recent developments in Canadian corporate law reform.[4] In sharp contrast to both the statutory and common law corporate traditions in both England and Canada, the oppression remedy secures a much broader involvement for the judiciary in corporate law affairs. Accordingly, the adoption of the remedy marks a significant, and long awaited, advance in the protection of shareholder rights and interests in Canada.[5] The potentially sweeping nature of the remedy, however, necessitates that due regard be paid to defining its ambit.[6] The open-ended wording means that this task has essentially been left to the judiciary.[7] To a large extent, this ambit remains poorly articulated and ill-defined. The rectification of this elusiveness was the goal that inspired the author to study the Canadian oppression remedy and detail the results of such analysis in this thesis.

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[1] R.S.C. 1985, c. C-44 [hereinafter *CBCA*].

[2] Stanley M. Beck, "Minority Shareholders' Rights in the 1980s" [1982] L.S.U.C. Special Lectures 311 at 312. All references to the oppression remedy herein will mean the current statutory oppression remedy found in section 241 of the *CBCA*, R.S.C. 1985, c. C-44, unless otherwise stated.

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[3] See *infra*, Chapter 1, Section III. B. for detailed information on which provinces have oppression legislation and the form of such legislation.

[4] Peterson states that the oppression remedy is "the most fascinating development in corporate law in recent times...": Dennis H. Peterson, *Shareholder Remedies in Canada* (Toronto: Butterworths, 1989, updated to 1997) at para 1.13.

[5] Bruce L. Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Toronto: Butterworths, 1991) at 554 & 564. Chapman notes that the oppression remedy has dramatically changed the relationship "between shareholders in corporations and the role of the courts in supervising that relationship": John J. Chapman, "Corporate Oppression: Structuring Judicial Discretion" (1996) 18 Adv. Q. 170 at 171. See also the *First Edmonton Place Ltd.* case which held "there can be little doubt that the statutory oppression remedy will radically reshape corporate law": *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.* (1988), 60 Alta.L.R. (2d) 122 at 141, 40 B.L.R. 28 (Q.B.), rev'd on other grounds (1989), 71 Alta.L.R. (2d) 61, 45 B.L.R. 110 (C.A.).

[6] Mary Anne Waldron, "Corporate Theory and the Oppression Remedy" (1981-82), 6 Can. Bus. L.J. 129 at 152; *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *ibid.* at 60 Alta.L.R. (2d) 141.

[7] The Alberta Court of Appeal interpreted this as a form of legislative delegation. See *Westfair Foods Ltd.* v. *Watt* (1991), 79 Alta. L.R. (2d) 363 at 369. See also Gower, at 742, where he comments that the English oppression remedy (which is not as broadly worded as the Canadian oppression remedy), "involves a sharing of legislative function between Parliament and the courts...": Paul L. Davies, ed. *Gower's Principles of Modern Company Law*, 6th. ed. (London: Sweet & Maxwell, 1997).

The current form of the statutory oppression remedy found within the *CBCA* made its first statutory appearance in Canada in 1975.[8] The section was intentionally worded very broadly. One reason for the flexible wording was to entice the courts away from their non-interventionist corporate tradition such that they would become more actively involved in monitoring corporate affairs.[9] Another reason was to better ensure that the remedy would be sufficiently flexible to operate within a variety of different corporate settings.[10] It is not practical to reduce the proscribed conduct to a list of specific actions. Each case depends, to a large degree, on its particular circumstance. An action may be oppressive in one circumstance, yet not in another. The remedy consequently requires a context dependent inquiry.

The inherent danger with this type of factually based analysis is the potential that each case will be explained away on its own facts. This tendency manifested itself in the early statutory oppression cases decided in Canada. The judges gave little guidance as to the application of the remedy except to comment that a party's conduct must accord with general principles of fairness.[11] Gradually the courts refined this fairness test through the endorsement of the more specific "reasonable expectations" test. This test requires a court to consider the entire circumstances of a case in order to assess the parties' underlying agreement.[12] In this regard, the courts must balance the often competing interests of the various corporate participants.[13] Without more, the "reasonable expectations" test does not provide satisfactory guidance. The general reluctance of the courts to discuss the test in any depth has left the substance of the test vague and the justification for the test insufficiently explained. As well, the rules or principles which help identify which expectations will be considered reasonable in the various circumstances must be clarified. In these regards, the current application of the "reasonable expectations" test does little to quell the concern that the open-ended nature of the oppression remedy may substantially erode the certainty and predictability of corporate law.[14]

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[8] *CBCA*, S.C. 1974-75-76, c. 33, s. 234. The words "oppression" and "oppressive", unless stated otherwise, are used in this thesis in the broad sense to include conduct that is oppressive, unfairly prejudicial or shows unfair disregard to the interests of a complainant. If the words "oppression" or "oppressive" are used concurrently with either or both of the phrases "unfair prejudice" or "unfair disregard," then the intention is to use the words in the restrictive sense.

[9] *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 5 at 60 Alta.L.R.(2d) 133, 140.

[10] See *infra*, Section II.C. of this Chapter One for additional information on, and further explanation of, these reasons.

[11] See *infra*, Chapter 2, Section II.B.

This thesis will focus on the "reasonable expectations" test and the extent to which it can serve as a useful theoretical device to guide the application of the oppression remedy.[15] This test is the dominant test currently endorsed by the Canadian courts to guide the application of the oppression remedy. The various aspects of the oppression remedy covered in this thesis are all ultimately relevant to legitimizing the use of the "reasonable expectations" test and to more clearly delineating its scope and structure.

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[12] See *infra*, Chapter 2, Section II.C.

[13] *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 5 at 60 Alta.L.R.(2d) 132-133.

[14] The Lawrence Committee, in 1967, recommended that Ontario not include a statutory oppression remedy in its corporate statute because of the potential uncertainty it would bring to corporate law. The Lawrence Committee was established by the Ontario government to consider corporate law reform in Ontario. Its recommendations relating to the oppression remedy can be found in the *Interim Report of the Select Committee on Company Law, Ontario, 1967* (Toronto: Queen's Printer, 1967) at para. 7.3.12 [hereinafter the *Lawrence Report*]. See also Welling who has noted that the inconsistent application of the remedy could result in a significant lack of certainty in corporate affairs: Welling, *supra*, note 5 at 565).

[15] The oppression remedy, due to its breadth, raises many different issues worthy of analysis. For example: the interplay between the oppression remedy and the derivative action; who should properly fall within the definition of "complainant"; the particular types of misconduct that may fall within the remedy's scope; *etcetera*. The author has chosen to focus the analysis on the governing test for the remedy due to the critical role it plays in steering the application of the remedy.

Chapter One of this thesis discusses the common law tradition as well as the statutory history of the oppression remedy in each of England and Canada. This history goes far to explain why the Canadian legislature endorsed such a broadly worded remedy. As well, an examination of the history helps one to understand the nature of the conduct the remedy is targeted to deter. The current oppression legislation in Canadian provincial and territorial statutes is also reviewed.

The first section in Chapter Two describes several differences between closely held and public corporations that are particularly relevant to an analysis of the oppression remedy. This review illustrates why an oppression claim is more likely to occur in closely held corporations or illiquid public corporations that have a dominant shareholder. It also provides insight into the types of situations that should properly fall within the ambit of the oppression remedy. The remaining sections in Chapter Two focus on the judicial application of the oppression remedy in Canada since its enactment. This analysis centres on the main tests used by the courts to assess whether the circumstances of a case warrant the application of the remedy. This judicial application can be broken down into two main periods. During the first period, the courts applied a very general fairness test and warned against generalizing beyond the facts of a given case. The second period was dominated by the application of the "reasonable expectations" test.

Chapter Three of this thesis briefly examines the American law on minority shareholder protection from oppression. The majority of the states provide either common law or statutory protection against shareholder oppression, or some combination of the two. Unlike that of Canada, the American approach to the application of the remedy tends to confine it to close corporations. Like its Canadian counterpart, the oppression protection supports the application of a "reasonable expectations" test. Although the American approach to the test also remains somewhat lacking in terms of adequate structure,[16] the judiciary in the United States shows a better appreciation of the focus of the "reasonable expectations" inquiry and the type of conduct which the remedy is intended to curb.

Chapter Four, the final chapter of this thesis, reviews the economic theory of "incomplete contracting." This theory provides insight into the structure and content of the "reasonable expectations" test. An appreciation of this theory in the oppression remedy context will consequently help to focus and justify the "reasonable expectations" test. This will generate greater certainty and consistency in the application of the oppression remedy. The increased predictability in the application of the oppression remedy will benefit the legal community as well as any person involved with a corporation.

The drafters of the prototype for the *CBCA* oppression legislation considered alleviation of the plight of the minority shareholder a primary goal of the remedy.[17] The availability of the oppression remedy is certainly not limited to minority shareholders.[18] The minority shareholder, however, is generally more vulnerable to oppression, particularly if the corporation is a closely held corporation. The minority shareholder is consequently the "primary category of persons who should be entitled to seek relief from oppression."[19] The emphasis in this thesis will therefore be on the oppression remedy as a means of providing minority shareholder protection.[20] This emphasis will be most obvious when analysing the history of the oppression remedy, the conduct the remedy is intended to discourage and the American jurisprudence and legislation.

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[16] Donald F. Clifford, Jr., "Close Corporation Shareholder Reasonable Expectations: The Larger Context" (1987) 22 Wake Forest L.R. 41 at 48.

[17] See R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada*, vol. 1 (Ottawa: Information Canada, 1971) at para. 484 [hereinafter sometimes referred to as the *Dickerson Report*]. The *Dickerson Report* is a two volume report which was prepared by a federally appointed committee established to consider Canadian corporate law reform. The committee's proposed form of the new act was set forth in volume 2 of the *Dickerson Report* [hereinafter sometimes referred to as *Canada's Draft Act*]. See also J. Anthony VanDuzer, "Who May Claim Relief From Oppression: The Complainant in Canadian Corporate Law" (1993) 25 Ottawa L.R. 463 at 477.

[18] Neither the oppression provision nor the definition of "complainant" contain any such restriction (see *CBCA*, R.S.C. 1985, c. C-44, s. 241 and s. 238 respectively). The courts have therefore not precluded majority or fifty percent shareholders from entitlement to the remedy. See Welling, *supra*, note 5 at 522; *Gottlieb* v. *Adam* (1994), 21 O.R. (3d) 248, 16 B.L.R. (2d) 271 (O.C.J.); *Carlson* v. *Trans-Pac Industries Corp.* (1990), 2 B.L.R. (2d) 70 (B.C.C.A.); *Oliver* v. *Ruge* (1989), 46 B.L.R. 50 (Ont.H.C.J.); *Naneff* v. *Con-crete Holdings Ltd.* (1995), 23 O.R. (3d) 481, 23 B.L.R. (2d) 286 (Ont. C.A.); *Borsook* v. *Borsook* (1994), 16 B.L.R. (2d)

There are definite differences in the specific wording of the statutory oppression remedies in each of Canada, the United States and England.[21] In certain respects, however, oppression jurisprudence from, and commentary on, the English and American jurisdictions are equally applicable in Canada. For example, jurisprudence and commentary on the "reasonable expectations" test and on the general types of corporate situations where oppression claims are more likely to arise. Also relevant are cases and literature that discuss why the more vulnerable parties do not obtain contractual or other protection. Therefore, when relevant, the author will herein refer to English and American jurisprudence and literature.

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265 (Ont.C.J.); *GATX Corp.* v. *Hawker Siddeley Canada Inc.* (1996), 27 B.L.R.(2d) 251 (Ont.Gen.Div.). Directors, officers and other "proper persons" (as determined by the courts) also have access to the oppression remedy.

[19] VanDuzer, *supra*, note 17 at 469.

[20] The term "minority shareholder" is used herein in the broad sense to mean any shareholder that does not have *de facto* control over the operations of the corporation, regardless of the number of shares such shareholder owns. See J.A.C. Hetherington and Michael P. Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem" (1977) 63 Va.L.R. 1 at 5 n.9 for a similarly broad definition.

[21] Canada has the broadest wording.

II. HISTORICAL ANALYSIS

Historically, England has had a significant influence on corporate law in Canada.[22] The oppression remedy found within the *CBCA*, although much broader in scope, derived from the English statutory oppression remedy.[23] Prior to detailing the statutory history of the oppression remedy, however, it is important to consider the common law background which prompted the enactment of statutory oppression remedies in both England and Canada.

A. Common Law - England and Canada

The oppression remedy found within the *CBCA* is in stark contrast to the previous Canadian and English corporate law traditions. Both countries had a longstanding history of judicial conservatism in matters of corporate law.[24] Early corporate statutes tended to restrict their focus to incorporation and the technical administration of same. The governance issues of corporate law were essentially left to the common law to develop.[25] The early jurisprudence followed the path of judicial non-intervention on the basis of what came to be known as the

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[22] Until 1949, decisions from Canada's highest court, the Supreme Court of Canada, were appealable to the Judicial Committee of the Privy Council in England. See Peter W. Hogg, *Constitutional Law of Canada*, 4th ed. (Toronto: Carswell, 1997) at 6. More recently, however, the United States has taken up a prominent role in influencing Canadian corporate law matters. For example, the registration procedure utilizing the articles of incorporation and bylaws corporate structure found in the *CBCA* and in the majority of the provincial corporate statutes was gleaned from precedents in the United States. See *Dickerson Report*, *supra*, note 17 at iv. of Preface and para. 508. See also Brian Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988) 10 U.Pa.J. Int. Bus. L. 305 at 307 & 309; Philip Anisman, "Majority-Minority Relations in Canadian Corporation Law: An Overview" (1986-87) 12 Can. Bus. L.J. 473.

[23] *Dickerson Report*, note 17 at para. 485; Cheffins, *ibid.* at 310.

[24] This judicial approach was not unique to corporate law. Contract law also reflected the laissez-faire attitude that was so prevalent at the time. See Chapman, *supra*, note 5 at 174.

[25] Waldron, *supra*, note 6 at 131; Welling, *supra*, note 5 at 516; Chapman, *ibid.*

"business judgment rule."[26] The "business judgment rule" stands for the principle that generally a court should not interfere with the internal operations of a corporation.[27] The case of *Burland* v. *Earle*[28] expanded the ambit of this principle by suggesting that the courts may not have jurisdiction to interfere. The specific statement in this regard, made by Lord Davey, on behalf of the Privy Council, was as follows:

> It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so.[29]

The judiciary, in subsequent cases, interpreted this quote as prohibiting the courts from intervening in corporate law matters unless the actions taken by the corporation were outside the corporation's powers.[30]

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[26] *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 5 at 60 Alta.L.R.(2d) 136. In reference to the English courts, Gower notes the "traditionally non-interventionist attitudes of the judges in relation to the internal affairs of companies": Davies, *supra*, note 7 at 735.

[27] *North-West Transportation Co.* v. *Beatty* (1887), 12 App. Cas. 589 (Ont., J.C.P.C.). In this case, an individual sold a personally owned asset to a corporation in which he was a director and the majority shareholder. The transaction was approved by a majority shareholder vote but only because the vendor voted his shares to support the transaction. The Privy Council upheld the transaction, notwithstanding the conflict of interest. It held that the shareholder was entitled to vote his shares in his own best interests and it was within the majority's jurisdiction to approve the transaction (the court, at 596, took notice of the corporation's need for the asset as well as the fact that the price for the asset was not excessive or unreasonable). A similar description of what is commonly referred to as the "business judgment rule" can be found in the case of *Shuttleworth* v. *Cox Bros. & Co. (Maidenhead) Ltd.* [1927] 2 K.B. 9 at 23 wherein Scrutton L.J. held: "It is not the business of the Court to manage the affairs of the company. That is for the shareholders and directors."

[28] [1902] A.C. 83 at 93 (Ont., J.C.P.C.) [hereinafter *Burland*].

[29] *Burland*, *ibid.* at 93. One of the issues in the *Burland* case was the propriety of a sale to a corporation, by the majority shareholder of the corporation, of an asset for a price approximately three times the original purchase price. The court upheld the transaction on the basis that the majority shareholder had no legal obligation to account for his profits in such circumstances.

[30] Welling, *supra*, note 5 at 512-14.

Two cornerstone corporate law principles serve as the foundation for the "business judgment rule": the principles of majority rule and separate legal personality.[31] The principle of majority rule supports the position that it is legitimate for the majority of the shareholders in a corporation to control the corporation. The shareholders appoint the directors who have the responsibility of running the business of the corporation. If the majority of shareholders are unsatisfied with the management of the business, they have the power to oust such directors. Therefore if a director has committed a wrong, yet the majority of the shareholders are prepared to overlook this wrong, then the majority rule principle dictates that it is not for the court to interfere with this decision.[32]

The principle that a corporation is a legal entity, separate from its members and management, is another well-established principle of corporate law.[33] This principle provided a further shelter from court intervention as courts felt they should respect the autonomy of a corporation by not interfering with its internal affairs. There were concerns that the courts did not have sufficient expertise to assess most business decisions and that judicial interference may jeopardize the corporation's independent status. Wrongs done to a corporation were held to be actionable by the corporation only. If the corporation chose not to take such action, it was generally not appropriate for other parties to sue on its behalf.[34] Therefore, "so far as the minority shareholder was concerned, a sort of *caveat emptor* was the rule of the day."[35]

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[31] Welling, *ibid.* at 510-12; *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 5 at 60 Alta.L.R.(2d) 132. Some people consider the principles of majority rule and the business judgment rule as two separate doctrines, the latter of which represents the principle of internal autonomy or separate legal personality. The author, however, feels that the more logical and coherent approach is to categorize the business judgment rule as representing both of these principles.

[32] *Foss* v. *Harbottle* (1843), 67 E.R. 189, 2 Hare 461. See *infra*, note 40 and accompanying text for certain exceptions to this rule.

[33] *Salomon* v. *Salomon & Co. Ltd.* [1897] A.C. 22 (Eng., H.L.).

[34] *Foss* v. *Harbottle*, *supra*, note 32 at E.R. 202; *Burland*, *supra*, note 28 at 93. See *infra*, note 40 and accompanying text for certain exceptions to this rule.

It is easy to see how these and related principles,[36] and the resulting judicial non-interference, could result in the victimization of minority shareholders.[37] Mismanagement or abuses by the majority shareholders, at the expense of the minority shareholders, could go largely unsanctioned.

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[35] Jeffrey G. MacIntosh, "Minority Shareholder Rights in Canada and England: 1860 - 1987" (1989) 27 Osgoode Hall L.J. 561 at 603.

[36] Other related principles, the first two of which are simply manifestations of the principles of majority rule and separate legal personality respectively, include:

a. ratification of a wrongdoers act by the majority of shareholders was, unless certain exceptions applied, an absolute bar to an action;
b. a shareholder has no property in the corporation's property as the corporation is the proper owner (For ex., see *Macaura* v. *Northern Assurance Co.* [1925] A.C. 619 at 626-27 (H.L.) wherein the court held that a shareholder has no insurable interest in the corporation's property.); and
c. a majority shareholder owes no fiduciary duty to minority shareholders (*North-West Transportation Co.* v. *Beatty*, *supra*, note 27 at 589-90, 601) or to the company (*Pender* v. *Lushington* (1877), 6 Ch.D. 70 at 75 (CA)) and thus is entitled to vote its shares in its own best interests;
d. directors owe their fiduciary duties to the corporation only, not to the shareholders (*Percival* v. *Wright* [1902] 2 Ch. 421).

[37] VanDuzer, *supra*, note 17 at 477; Welling, *supra*, note 5 at 509; *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 5 at 60 Alta.L.R.(2d) 132, 136. Welling also recognized that the unfortunate position of a minority shareholder was noticed as early as 1931: Welling, *supra*, note 5 at 509 n. 179. See also *Re Jury Gold Mine Dev. Co.* [1928] 4 D.L.R. 735 at 736 (Ont.C.A.) wherein Middleton, J.A. held that a minority shareholder:

> ... must endure the unpleasantness incident to that situation. If he choose to risk his money by subscribing for shares, it is part of his bargain that he will submit to the will of the majority. In the absence of fraud or transactions *ultra vires*, the majority must govern, and there should be no appeal to the Courts for redress.

The principles had a similar effect in the United States, which gave rise to both the common law and statutory protection for minority shareholders. See F. Hodge O'Neal and Robert B. Thompson, *O'Neal's Close Corporations*, 3rd ed. (New York, N.Y.: Clark Boardman Callaghan, 1987, updated to 1997) at 8-85.

This is not to say that there were no common law remedies available to the minority shareholder. There was authority for a common law oppression remedy which prohibited fraudulent or oppressive conduct.[38] As well, although the "Rule in *Foss* v. *Harbottle*"[39] only allowed the company to sue its directors for their misconduct, several exceptions arose to alleviate some of the harshness of the rule. One of the exceptions was where there was a fraud on the minority shareholders.[40] This exception was essentially limited to situations where there was an "appropriation of corporate assets or the grossest sort of overreaching by majority shareholders."[41] There was also the statutory remedy of winding up that was set forth in section 222 of the *Companies Act, 1948* (U.K.).[42] Terminating the existence of a corporation however, has always been conceived of as a drastic remedy. Therefore the courts were generally reluctant to grant this remedy.[43]

The common law minority shareholder remedies will not be analysed in detail in this thesis. The intention behind the statutory oppression remedy was to facilitate a significant departure from the common law treatment, and not to simply codify the common law.[44] Yet it is important to note the existence of these common law remedies as well as the fact that they generally required proof of extreme misconduct and thus were of limited protection to the minority shareholder.[45]

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[38] Anisman, *supra*, note 22 at 475-76; Waldron, *supra*, note 6 at 133.

[39] Derived from the *Foss* v. *Harbottle* case, *supra*, note 32.

[40] The Jenkins Committee, which was established by the English government to consider company law amendments, described this exception as a "notoriously vague concept" in its *Report of the Company Law Committee*, United Kingdom, Cmnd. 1749 (1962) at 76 [hereinafter the *Jenkins Report*]. Other exceptions to the rule include: when the conduct was illegal or outside the powers of the company, when there was an irregularity in the passing of a resolution requiring majority approval or if the conduct infringed the personal rights of an individual shareholder. See MacIntosh, *supra*, note 35 at 600-01; Allen B. Afterman, "Statutory Protection For Oppressed Minority Shareholders: A Model for Reform" (1969) 55 Va. L.R. 1043 at 1047-48 n. 20. See also the English case of *Edwards* v. *Halliwell* [1950] 2 All ER 1064 (C.A.) for a good summary of the exceptions.

[41] MacIntosh, *ibid.* at 601.

[42] 1948, 11& 12 Geo. 6, c. 38 (U.K.).

[43] John P. Lowry, "The Oppression Remedy - A Canadian Approach" [1991] J.B.L. 196; Cheffins, *supra*, note 22 at 309.

B. Statutory History - England

The growing concerns over the vulnerability of the minority shareholder prompted the enactment of a statutory oppression remedy in England in 1948.[46] The statutory oppression remedy was enacted pursuant to the recommendations of the Cohen Committee.[47] Notwithstanding this statutory reform, the courts remained loyal to their non-interventionist past. The wording of this early English statutory oppression remedy was considerably more restrictive than the remedy currently found within the *CBCA*.[48] The remedy's restrictive wording, coupled with the judicial reluctance to intervene in these types of corporate disputes, resulted in very few applicants being successful under this remedy.[49] The courts interpreted section 210 as requiring the following:

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[44] *Mason* v. *Intercity Property Ltd.* (1987), 38 D.L.R.(4th) 681 (Ont.C.A.) at 685; *Ferguson* v. *Imax Systems Corp.* (1983), 150 D.L.R.(3d) 718 at 727, 43 O.R.(2d) 128 (C.A.), rev'g 134 D.L.R.(3d) 519, 38 O.R.(2d) 59, 28 C.P.C. 290 (rev'g 12 B.L.R. 209), leave to appeal to the S.C.C. refused 52 N.R. 317*n*; 2 O.A.C. 158*n*. *Ferguson* v. *Imax Systems* Corp., *supra*, was cited with approval in *Keho Holdings Ltd.* v. *Noble* (1987), 52 Alta.L.R.(2d) 195 at 201, 38 D.L.R.(4th) 368 and in *Such* v. *RW-LB Holdings Ltd.* (1993), 15 Alta.L.R.(3d) 153 at 168, 147 A.R. 241, 11 B.L.R.(2d) 122 (Q.B.).

[45] Waldron, *supra*, note 6 at 133; Anisman, *supra*, note 22 at 475-76; Cheffins, *supra*, note 22 at 308; VanDuzer, *supra*, note 17 at 477. The Alberta Law Reform Institute (formerly known as the Institute of Law Research and Reform), in its proposals for corporate law reform set out in its *Report No. 36 Proposals for a New Alberta Business Corporations Act*, vols. 1 & 2 (Edmonton: Institute of Law Research and Reform, 1980), commented that "the present Alberta law relating to the abuse of the power of control of a company is unsatisfactory...": vol. 1 at 142.

[46] *Companies Act, 1948* (U.K.), 1948, 11 & 12 Geo. 6, c. 38, s. 210 (U.K.).

[47] The Cohen Committee was established to review the then current state of company law in England and consider what improvements would be advisable. The recommendation was set forth in the *Report of the Committee on Company Law Amendment*, United Kingdom, Cmnd. 6659 (1945) at 95.

(a) the shareholder must prove oppression, not simply conduct that is unfairly prejudicial or that shows unfair disregard to a shareholder;

(b) there must be a continuous course of oppressive conduct, not simply an isolated act;

(c) the conduct must be of sufficient gravity to justify a winding up order on the "just and equitable" ground except that such an order would unfairly prejudice the minority; and

(d) the oppression must be suffered by the shareholder in its capacity as a shareholder.[50]

One legal scholar located only two reported English cases where the court found oppression based on section 210 of the *Companies Act, 1948 (U.K.)*.[51]

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[48] The specific wording of the English statutory oppression remedy found in the *Companies Act, 1948* (U.K.), 1948, 11 & 12 Geo. 6, c. 38, s. 210 (U.K.) was as follows:

> s. 210(1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself)... may make an application to the Court by petition for an order under this section.
>
> (2) If on any such petition the Court is of the opinion:
> (a) that the company's affairs are being conducted as aforesaid; and
> (b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up,
> the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in the future, or for the purchase of the shares of any members of the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

[49] Davies, *supra*, note 7 at 740.

[50] *Dickerson Report*, *supra*, note 17 at para. 485; Waldron, *supra*, note 6 at 135-36; E.A. Cronk and Paul F. Monahan, "The Oppression Remedy Revisited" (1989-90) 11 Adv. Q. 393 at 395.

The ineffectiveness of the statutory oppression remedy in England was soon recognized, yet legislative reform did not take place until 1980.[52] In accordance with the recommendations of the *Jenkins Report*, the 1980 *Companies Act* (U.K.) contained a new statutory oppression remedy which significantly broadened its potential application.[53] The major amendments were as follows:

(a) the broader ground of "unfair prejudice" replaced the more restrictive requirement that "oppression" be proven; and

(b) the facts did not have to justify a "winding up."[54]

The oppression remedy's lack of effectiveness in England had a significant influence on Canadian oppression legislation. It prompted the adoption, in 1975, of the more broadly worded oppression remedy found within the *CBCA*.[55]

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[51] 1948, 11 & 12 Geo. 6, c. 38. See L.C.B. Gower, *Principles of Modern Company Law*, 4th ed. (London: Stevens & Sons, 1979) at 665-66. The two cases were *Scottish Co-Operative Wholesale Society Ltd.* v. *Meyer* [1959] A.C. 324 (H.L.) and *Re H.R. Harmer Ltd.* [1958] 3 All E.R. 689 (CA). See also Lynden Griggs & John P. Lowry, "Minority Shareholder Remedies: A Comparative View" [1994] J.B.L. 463 at 465 n. 9 and accompanying text.

[52] The need for reform was set out in the 1962 *Jenkins Report*, *supra*, note 40.

[53] 1980, c. 22, s. 75. The wording of the amended section read as follows:

> A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or* some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including any act or omission on its behalf) is or would be so prejudicial.

*The underlined portion represents the 1989 amendment - see, *infra*, note 54.

[54] The wording of the remedy was then repeated *verbatim* in the *Companies Act* (U.K.), 1985, c. 6, ss. 459 - 461. The section was subsequently amended in 1989 by the *Companies Act* (U.K.), 1989, Sched. 19, para 11, s. 459 - 461 by the addition of the phrase "its members generally or" after the phrase "prejudicial to the interests of." This amendment was to clarify that the remedy would be applicable even if all of the shareholders were affected in an equally detrimental fashion.

C. Statutory History - Canada (Federal and Provincial)

In Canada, the federal government set up a task force in 1967 under Dr. R.W.V. Dickerson to consider the appropriate contents of a new federal corporate statute.[56] Its recommendations, which are set forth in the *Proposals for a New Business Corporations Law for Canada*,[57] were very influential in shaping current corporate law in Canada.[58] With respect to the issue of oppression, the *Dickerson Report* expressly noted the inability of the common law to provide adequate protection to minority shareholders.[59] It stated that "the position of the minority shareholder has always been an exceptionally unenviable one."[60]

The *Dickerson Report* contained numerous recommendations on how to help alleviate the unfortunate position of the minority.[61] The most relevant recommendation, for the purposes of this thesis, was that the federal corporate statute include a statutory oppression remedy.

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[55] *Dickerson Report*, *supra*, note 17 at para. 485.

[56] Hereinafter sometimes referred to as the *Dickerson Committee*.

[57] *Dickerson Report*, *supra*, note 17, vols. 1 & 2.

[58] MacIntosh, *supra*, note 35 at 578. The recommendations formed the basis of the *CBCA*, the format of which was then substantially adopted by each of Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick and Newfoundland.

[59] *Dickerson Report*, *supra*, note 17 at para. 114-15.

[60] *Dickerson Report*, *ibid.* at para. 23.

[61] For example, the shareholder appraisal remedy. See Jeffrey G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1986) 24 Osgoode Hall L.J. 201 for a comprehensive analysis of both the *Dickerson Committee*'s recommendations and the remedy.

the proposed form of which was also set out in the *Dickerson Report*.[62] Although derived from the English statutory oppression remedy, the wording of the proposed remedy was much broader in scope. This was partially based on the recognition that England's statutory oppression remedy failed to provide adequate protection.[63] It was hoped that more expansive wording would encourage courts to move away from their tradition of non-intervention and thereby make the remedy more effective.[64] The *Dickerson Committee* clearly contemplated that the courts would intervene in matters of internal management.[65] The remedy's broad wording was also tied to the *Dickerson Committee*'s recognition that the myriad of different corporate forms made it impossible to draft a remedy that could specifically delineate all of the different types of prohibited conduct. The *Dickerson Report* states:

> ... given the protean quality of the business corporation as a legal institution and the seemingly inexhaustible ingenuity of the unscrupulous to exploit this quality to further their own ends, it is impossible for the draftsman to

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[62] *Dickerson Report*, *supra*, note 17 at para. 484 & 485. The form of such remedy can be found in *Canada's Draft Act* portion of the *Dickerson Report*, *supra*, note 17, vol. 2, s. 19.04.

[63] *Dickerson Report*, *ibid.* at para. 485. At that time, England still used the wording found within s. 210 of the *Companies Act, 1948* (U.K.), 1948, 11 & 12 Geo. 6, c. 38.

[64] See the *Dickerson Report*, *ibid.* The *Dickerson Committee* relied, in part, on the recommendations contained within the *Jenkins Report*, *supra*, note 40 when determining what modifications should be made to the original statutory remedy found within s. 210 of the *Companies Act, 1948*, *ibid.* England did not implement the recommendations set forth in the *Jenkins Report* until 1980.

[65] This is evident from the examples set out in the *Dickerson Report* of the types of conduct that might violate the oppression section:

> ...where dominant shareholders appoint themselves to paid offices of the corporation, absorbing any profits that might otherwise be available for dividends; the issue of shares to dominant shareholders on advantageous terms; or the repeated passing of dividends on shares held by a minority group.

See *Dickerson Report*, *ibid.* at para. 484.

anticipate all of the possibilities of misuse.[66]

The *Dickerson Committee* also advocated the use of more generally worded remedies because it felt that flexibility of the corporate form was very important. *Canada's Draft Act* was therefore designed to be permissive in scope, with as few technical rules as possible.[67] The *Dickerson Committee* consequently favoured the use of several general remedies to safeguard the valued competing interests, as opposed to imposing numerous specific restrictions that could be unnecessarily confining and/or useless. It sought to achieve the goal of enhanced shareholder protection, without unduly restricting the flexibility of the corporate form through the imposition of potentially ineffective specific rules.

The federal government heeded this and many other recommendations contained within the *Dickerson Report* which resulted in the proclamation, on December 15, 1975, of the *CBCA*.[68] The wording of the statutory oppression remedy found within the *CBCA* was much broader than any other oppression remedy enacted in the common law world.[69] The oppression remedy enacted in the *CBCA* differed from the English predecessor found in section 210 of the *Companies Act, 1948* (U.K.)[70] in many ways. The most significant differences were as follows:

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[66] *Dickerson Report*, *ibid.* at para. 474. Indeed, "defining, gauging and controlling abuse in the corporate context is a complex and difficult task": Peterson, *supra*, note 4 at para. 1.14.

[67] *Dickerson Report*, *ibid.* at para. 115 & 474. As noted by Peterson, the *CBCA* is "enabling legislation": Peterson, *ibid.* at para. 1.11.

[68] S.C. 1974-75-76, c. 33. Section 234 contained the oppression remedy which was very similar to the recommended wording found in s. 19.04 of *Canada's Draft Act*.

[69] Beck, *supra*, note 2 at 312. Other common law jurisdictions which have enacted oppression legislation are as follows: New Zealand (*Companies Act 1993*, s. 174); Australia (*Corporations Law 1989*, s. 260; Ghana (*Companies Act 1961*, s. 218); Singapore (*Companies Act 1965*, s. 181); Malaysia (*Companies Act 1967*). In general, most of these statutory forms are broader than the oppression remedy first adopted in England (ie. *Companies Act, 1948 (U.K.)*, 11 & 12 Geo. 6, c. 38, s. 210), but more restrictive than the wording used in the *CBCA*.

(a) the complainant did not have to prove that there were just and equitable grounds to wind up the corporation;

(b) the grounds for relief were broadened beyond mere oppression to include conduct that was either unfairly prejudicial or that unfairly disregarded the interests of the complainant;

(c) the conduct could be a single event, as opposed to requiring a continuous course of wrongful conduct; and

(d) the complainant could suffer the harm in its capacity as security holder, creditor, director or officer and not simply in its capacity as a shareholder.[71]

The current wording of the oppression remedy found within the *CBCA* remains almost identical to the original *CBCA* version.[72]

The statutory oppression remedy found within the *CBCA* was not the first statutory oppression remedy enacted in Canada. In 1960, the province of British Columbia enacted the *Companies Act* which contained a statutory oppression remedy.[73] This statute constituted the first piece of legislation in Canada to include a statutory oppression remedy. The wording of the remedy, however, copied the more restrictive wording found within the United Kingdom's *Companies Act, 1948*.[74] The statutory oppression remedy in British

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[70] 1948, 11 & 12 Geo. 6, c. 38 (U.K.).

[71] See *infra*, Section III. of this Chapter One for the specific wording of the statutory oppression remedy found within the *CBCA*.

[72] The oppression remedy is now found in s. 241 of the *CBCA*, R.S.C. 1985, c. C-44, as amended. The only difference between the current section and the original remedy, apart from changes in the section numbers, is the clarification in s. 241(3)(e) of the power formerly set out in s. 234(3)(e).

[73] R.S.B.C. 1960, c. 67, s. 185.

[74] 1948, 11 & 12 Geo. 6, c. 38, s. 210.

Columbia has since undergone several amendments which have served to broaden its ambit. The wording still remains somewhat more restrictive in several respects than the remedy found within the *CBCA*.[75]

The majority of the provinces in Canada have adopted a statutory oppression remedy for their respective provincial corporate statutes that is either identical, or very similar, to the wording used in the *CBCA*. The status of the statutory oppression remedy in each of the provincial and territorial jurisdictions is detailed *infra*, in Section III. of this Chapter One.

III. CURRENT OPPRESSION LEGISLATION IN CANADA

A. Federal Oppression Legislation

The federal statutory oppression remedy is currently found within section 241 of the *CBCA*. The most relevant subsections for the purposes of this thesis are as follows:

> 241. (1) A complainant may apply to a court for an order under this section.
>
> (2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates
>
> (a) any act or omission of the corporation or any of its affiliates effects a result,
>
> (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
>
> (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may

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[75] See *infra*, Section III.B. of this Chapter One for more specific information on the oppression legislation in British Columbia.

make an order to rectify the matters complained of.

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

- (a) an order restraining the conduct complained of;
- (b) an order appointing a receiver or receiver-manager;
- (c) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;
- (d) an order directing an issue or exchange of securities;
- (e) an order appointing directors in place of or in addition to all or any of the directors then in office;
- (f) an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;
- (g) an order directing a corporation, subject to subsection (6), or any other person, to pay to a security holder any part of the moneys paid by him for securities;
- (h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;
- (i) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 155 or an accounting in such other form as the court may determine;
- (j) an order compensating an aggrieved person;
- (k) an order directing rectification of the registers or other records of a corporation under section 243;
- (l) an order liquidating and dissolving the corporation;
- (m) an order directing an investigation under Part XIX to be

> made; and
>
> (n) an order requiring the trial of any issue.[76]

Subsection (2) delineates the conditions upon which an oppression claim can be made by a complainant. Subsection (3) outlines the broad powers available to the court when granting relief.

Section 238 of the *CBCA* contains the following definition of "complainant":

> 238. In this Part, ...
>
> "complainant" means
>
> (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
>
> (b) a director or an officer or a former director or officer of a corporation or any of its affiliates,
>
> (c) the Director, or
>
> (d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.[77]

The three grounds of unfair prejudice, unfair disregard and oppression in the *CBCA* provision significantly increase the ambit of the remedy when compared with its English predecessor enacted in 1948.[78] The *Dickerson Report* notes that expanding the remedy beyond "oppression" to include "unfair prejudice" and "unfair disregard" ensures the remedy applies where the conduct is wrongful, even though not unlawful.[79] Equitable principles confirm that a cause of action under the oppression remedy may be available to an applicant even though the applicant's legal rights *per se*, have not been infringed. Also noteworthy is the wording which provides that the remedy is not restricted to situations where the applicant has suffered the oppression, unfair prejudice or unfair disregard in the shareholder capacity. This is particularly important when one considers the multiple roles a person may occupy in a closely held corporation.[80] In such corporations, the wrongful conduct may affect an applicant in a managerial or employment capacity and not directly in the applicant's capacity as a shareholder.

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[76] *CBCA*, R.S.C. 1985, c. C-44, s. 241. This is not the entire section as there are a total of seven subsections.

[77] *CBCA*, *ibid.* at s. 238.

[78] *Companies Act, 1948* (U.K.), 1948, 11 & 12 Geo. 6, c. 38, s. 210. The differences are described in more detail *supra,* in Section II.C. of this Chapter One.

The procedure to be followed by the applicant to enforce the statutory remedy is simple, as long as there are no factual issues in dispute. The *Dickerson Committee* felt this was important to help facilitate access to the remedy.[81] The process may be commenced by way of application, instead of statement of claim. The cost and delay associated with pleadings and discoveries can therefore be avoided, provided there are no factual issues in dispute. The specific application procedures will depend on the civil procedure rules applicable in each jurisdiction.[82]

Subsection 241(3) enumerates the broad powers available to the court when granting relief pursuant to this section. The *Dickerson Committee* intended that the courts have a "wide discretion to make the appropriate remedial orders."[83] The court's mandate is to rectify the oppressive conduct. The *Dickerson Committee* thought the range of remedies available would help a court execute this mandate without being unduly punitive to, or causing unnecessary interference with, the corporation.[84]

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[79] *Dickerson Report, supra*, note 17 at para. 485.

[80] A "closely held" corporation is not defined in the *CBCA*. See *infra,* Chapter 2, Section I.A.3. for a description of the characteristics commonly associated with a "closely held" corporation.

[81] *Dickerson Report, supra*, note 17 at para. 13 & 23.

[82] Welling, *supra*, note 5 at 524.

[83] *Dickerson Report, supra*, note 17 at para. 13.

B. Oppression Legislation in the Provinces and Territories

In Alberta, the corporate law structure was significantly changed in 1981 with the proclamation of the *Business Corporations Act*.[85] Prior to the enactment of this new statute, the Institute of Law Research and Reform, now called the Alberta Law Reform Institute,[86] undertook the task of analysing the state of corporate law in Alberta, with a view to reform.[87] The *Alberta Institute*'s recommendations had a tremendous influence on the statutory content of the *ABCA*.[88] In general, its recommendations tended to echo the recommendations of the *Dickerson Committee* and the statutory wording found within the *CBCA*.[89] This support extended to the statutory oppression remedy found in the *CBCA*. Consequently, the statutory oppression remedy found within the *ABCA* is substantially similar to the remedy found in the

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[84] *Dickerson Report, ibid.* at para. 486.

[85] S.A. 1981, c. B-15, s. 234 [hereinafter the *ABCA*].

[86] Hereinafter sometimes referred to as the *Alberta Institute*.

[87] The *Alberta Institute*'s proposals were contained within the *Report No. 36 Proposals for a New Alberta Business Corporations Act*, vols. 1 & 2 (Edmonton: Institute of Law Research and Reform, 1980) [hereinafter the *Alberta Report*]. Volume 2 of the *Alberta Report* contained a draft form of the new corporate statute [hereinafter sometimes referred to as *Alberta's Draft Act*].

[88] With respect to the oppression remedy, the *ABCA* adopted the wording set forth in *Alberta's Draft Act verbatim*. See *Alberta Report, ibid.*, vol. 2, at 324 - 26.

[89] The *Alberta Institute* recognized the importance of having substantial uniformity between the two types of corporate law that would be in force in the province and particularly in the area of shareholder remedies: *Alberta Report, ibid.* vol. 1, at 3, 5, 145. As well, the *Alberta Institute* felt that the *CBCA* was an "excellent piece of legislation which takes into account the modern work done in Canada and the United States": *Alberta Report, ibid.* vol. 1, at 6.

CBCA.[90]

The majority of the other provinces have also incorporated statutory oppression legislation into each of their respective corporate statutes. These provinces include Saskatchewan, Manitoba, Ontario, New Brunswick, Newfoundland and Nova Scotia.[91] The Yukon Territory and the Northwest Territories have also enacted statutory oppression remedies.[92] The form of the oppression legislation found within each of the above referenced provincial and territorial corporate statutes, in terms of the grounds and remedial powers of the courts, is either identical, or very similar, to the form found within the *CBCA*.[93] Therefore many of the comments made herein in relation to the *CBCA* oppression remedy will accordingly apply to the oppression remedies found within each of these jurisdictions.

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[90] The grounds for the oppression remedy are identical in both the *ABCA* and the *CBCA* (s. 234(2) *ABCA*; s. 241(2) *CBCA*). Both sections also include a non-exhaustive list of powers available to a court when making an order under the oppression section, however there are several differences in their respective lists (s. 234(3) *ABCA*; s. 241(3) *CBCA*). These differences are as follows: the *ABCA* does not list the creation or amendment of a unanimous shareholder agreement as a specific power yet it does state that any order amending the articles or bylaws operates notwithstanding a unanimous shareholder agreement (ss. 234(3)(c) & (d) *ABCA*); the *ABCA* expressly authorizes an order allowing for the payment of dividends (ss. 234(3)(i)); the *ABCA* allows the court to grant the relief it could give in an application under the derivative action section to ensure an applicant is not deprived of a remedy simply because it wrongly proceeded under the oppression remedy section. See *Alberta Report*, *ibid.* vol. 1, at 142 & 143; vol. 2, at 324 - 329.

[91] Saskatchewan: *The Business Corporations Act*, R.S.S. 1978, c. B-10, s. 234 [hereinafter *SBCA*]; Manitoba: *The Corporations Act*, R.S.M. 1987, c. C225, s. 234 [hereinafter *MCA*]; Ontario: *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 248 [hereinafter *OBCA*]; New Brunswick: *Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 166 [hereinafter *NBBCA*]; Newfoundland: *Corporations Act*, R.S.N. 1990, c. C-36, s. 371 [hereinafter *NCA*]; Nova Scotia: *Companies Act*, R.S.N.S. 1989, c. 81, Third Schedule, s. 5 (as amended by the *Investors Protection Act*, S.N.S. 1990, c. 15, s. 17 bringing into effect the Third Schedule to the *Companies Act*) [hereinafter *NSCA*]. Although several of the provinces set up committees to consider corporate law reform, the *Lawrence Report* (which was prepared for Ontario's 1970 corporate law reform), *supra*, note 14, and the *Alberta Report*, *ibid.* are the only provincial reports that have been published by their respective committees. See Brian R. Cheffins, "An Economic Analysis of the Oppression Remedy: Working Towards a More Coherent Structure of Corporate Law" (1990) 40 U.T.L.J. 775 at 777 n. 6.

[92] *Business Corporations Act*, R.S.Y.T. 1986, c. 15, s. 243 [hereinafter *YBCA*]; *Business Corporations Act*, S.N.W.T. 1996 c. 19, s. 243 [hereinafter *NWTBCA*].

British Columbia, as previously noted, was the forerunner in adopting statutory oppression legislation in Canada. The wording of the remedy has been substantially amended from its original form, yet in contrast with many of the other Canadian provinces, it has not adopted the general format of the oppression remedy set forth in the *CBCA*. The wording of the current section, found within s. 200 of the *Company Act*,[94] although more restrictive than the *CBCA* oppression remedy in several respects, is similar in principle.[95]

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[93] The similarities and differences, in terms of the grounds and remedial powers of the courts, between the provincial / territorial oppression remedies and the remedy found in the *CBCA* are as follows:

- Saskatchewan - s. 234(2) & (3) *SBCA* are identical to s. 241(2) & (3) *CBCA*;
- Manitoba - s. 234(2) & (3) *MCA* are identical to s. 241(2) & (3) *CBCA*;
- Ontario - s. 248(2) & (3) *OBCA* are identical to s. 241(2) & (3) *CBCA* except that s. 248(2) *OBCA* includes threatened conduct and thus does not require the misconduct to have already occurred;
- New Brunswick - s. 166(2) & (3) *NBBCA* are identical to s. 241(2) & (3) *CBCA* except s. 166(2) *NBBCA* expressly includes "creditor" and uses the term "shareholder" where s. 241(2) *CBCA* uses the phrase "security holder";
- Newfoundland - s. 371(2) & (3) *NCA* are identical to s. 241(2) & (3) *CBCA*;
- Nova Scotia - s. 5(2) & (3) *NSCA* are identical to s. 241(2) & (3) *CBCA* except s. 5(3)(c) *NSCA* refers to "memorandum or articles" instead of "articles and bylaws" and does not specifically authorize the creation or amendment of a unanimous shareholder agreement as a specific power;
- Yukon Territory - s. 243 *YBCA* is identical to s. 234 *ABCA* therefore see *supra*, note 90 for how it differs from s. 241(2) & (3) of the *CBCA;*
- Northwest Territories. - s. 243(2) *NWTBCA* is identical to s. 241(2) *CBCA*; s. 243(3) *NWTBCA* is very similar to 243(3) *ABCA* with the only real difference being that the *NWTBCA* states that the court can order the creation or amendment of a unanimous shareholder agreement. Therefore see *supra*, note 90 for how it differs from s. 241(3) *CBCA*.

[94] R.S.B.C. 1996, c. 62.

[95] On a general note, the form of s. 200 *BCCA* is quite different from s. 241 *CBCA*. More specifically, the main differences are as follows: the *BCCA* remedy does not include "unfair

Prince Edward Island is the only common law jurisdiction in Canada which has not yet adopted a statutory oppression remedy in its corporate statute. Quebec also does not have any oppression legislation, however it is a civil law jurisdiction.

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disregard" as a separate ground of relief; the *BCCA* remedy allows a claim to be made based on threatened conduct; the *CBCA* remedy specifically refers to any "act or omission" of the corporation whereas the *BCCA* remedy refers only to an "act"; although both statutes include a non-exhaustive list of potential orders to be granted by the court to rectify the oppressive conduct, the specific lists are not identical. Unlike the *CBCA* remedy, the list of potential powers available to the court under the *BCCA* oppression section includes a provision that potentially allows an applicant to circumvent the derivative action section.

CHAPTER TWO

JUDICIAL APPLICATION OF THE OPPRESSION REMEDY IN CANADA

The broad wording of the oppression remedy ensures it is capable of very wide application. This Chapter will examine the judicial application of the oppression remedy in Canada since its enactment. Prior to a detailed consideration of the remedy's application, it is worthwhile to compare several types of corporations that exist in Canada.

I. DIFFERENT TYPES OF CORPORATIONS

There are many different "types" of corporations that can exist in Canada.[1] For the purposes of the oppression remedy, it is important to consider the type of corporation in terms of whether it is:

(a) a widely held public corporation that does not have a controlling shareholder[2] and that has liquid share holdings;

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[1] Corporations may be categorized in a number of different ways. Several examples include: by the type of business they carry on; by their jurisdiction, either legislative or geographical, of incorporation; by the nature or size of the membership; by their financial size; and by whether they are non-profit as opposed to for profit corporations.

[2] Herein the term "controlling shareholder" means a shareholder (or a group of shareholders) that has the dominant influence over the corporation. It is not necessary for such a shareholder (or group of shareholders) to own a majority of the voting shares. It is enough if the number of voting shares owned by the shareholder (or group of shareholders) substantially outnumbers the voting shares owned by the other shareholders and is of sufficient number to have control over management. For example, a shareholder that only owns one-third of the issued voting shares may be said to control the corporation if the remaining shares are widely dispersed. As well, it is not necessary that a shareholder own a proportionate amount of equity in order to be considered in control.

(b) a public corporation that has a controlling shareholder and fairly illiquid share holdings; and

(c) a closely held corporation.

When considering the oppression remedy, most authors focus solely on the differences between public and closely held corporations. They fail to distinguish between the two types of public corporations listed above.[3] Instead, public corporations are viewed as a homogenous category, with features most typical to that of a widely held public corporation that has very liquid share holdings.[4] Comments stating that oppression claims are unlikely to arise in public corporations generally mean public corporations that have these features. The majority of public corporations in Canada, however, do not have

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For example, in *Pente Investment Management Ltd.* v. *Schneider Corp.* [1998] O.J. No. 2036 (Gen.Div.), the controlling shareholder(s) held only twenty-two percent of the equity, yet sufficient votes to pass a special majority.

[3] For example, see Robert B. Thompson, "Corporate Dissolution and Shareholders' Reasonable Expectations" (1988) 66 Wash. U.L.Q. 193 at 216-17; J.A.C. Hetherington, "Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities" (1987) 22 Wa. For. L.R. 9 at 19-21; John J. Chapman, "Corporate Oppression: Structuring Judicial Discretion" (1996) 18 Adv. Q. 170 at 171; John A. Campion, Stephanie A. Brown & Alistair M. Crawley, "The Oppression Remedy: Reasonable Expectations of Shareholders" [1995] L.S.U.C. Special Lectures 229 at 250-252.

However, Campion *et al* did mention, when reviewing two oppression cases involving public corporations, that both had liquidity problems (in one case, the complainant's class of shares had been delisted: *Westfair Foods Ltd.* v. *Watt* (1991), 79 Alta.L.R.(2d) 363, 94 D.L.R. (4th) 733, 5 B.L.R. (2d) 160 (C.A.), leave to appeal to the S.C.C. refused 101 D.L.R. (4th) viii., 141 A.R. 317*n*; in the other case, the market value of the shares was well below their true value: *Palmer* v. *Carling O'Keefe Breweries of Canada* (1989), 56 D.L.R. (4th) 128, 67 O.R.(2d) 161, 41 B.L.R. 128 (Div.Ct.), leave to appeal to the Ont.C.A. refused May, 1989): Campion, Brown & Crawley, *supra*, at 251.

[4] This type of public corporation is much more common in the United States: Jeffrey G. MacIntosh with Janet Holmes and Steve Thompson, "The Puzzle of Shareholder Fiduciary Duties" (1991) 19 Can.Bus. Law J. 86 at 87.

these characteristics.[5]

Several Canadian authors, in contrast to most other corporate scholars, have begun to emphasize the important differences between very liquid widely held public corporations and less liquid public corporations that have one or more controlling shareholders.[6] In the course of their review, these authors note the increased potential for inter-shareholder conflict in public corporations that have dominant shareholders.[7] This increases the likelihood of an oppression claim. Illiquid share holdings also enhance this likelihood. The prevalence of this type of public corporation in Canada renders it imperative that, when pursuing an analysis of the oppression remedy, one recognize the distinctive features of the two types of public corporations described *supra*. Otherwise, it may be mistakenly assumed that the oppression remedy is of little relevance to public corporations.

The oppression remedy is applicable to all three types of corporations. Yet, it will have a greater impact on closely held corporations and illiquid public corporations that have a controlling shareholder. The *CBCA* does not provide definitions for the three types of corporations listed above. While there is some overlap, each type of corporation has distinctive characteristics which are delineated in the next section.[8]

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[5] MacIntosh, Holmes & Thompson, *ibid.* at 87; Ronald J. Daniels & Jeffrey G. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime" (1991) 29 Osgoode Hall L.J. 863 at 877, 885.

[6] MacIntosh, Holmes & Thompson, *ibid.* at 87, 88; Daniels & MacIntosh, *ibid.* at 885-886. It is also recognized that some public corporations fall between these two types: Daniels & MacIntosh, *ibid.* at 877-78.

[7] MacIntosh, Holmes & Thompson, *ibid.* at 87, 88; Daniels & MacIntosh, *ibid.*

[8] The characteristics commonly associated with closely held corporations and the stereotypical public corporation are typical regardless of whether the corporation was incorporated in the United States, England or Canada. The stereotypical public corporation is a corporation that is widely held and has highly liquid shares. Therefore

A. Differences Between Each Type of Corporation And Their Impact on the Applicability of the Oppression Remedy

1. Highly Liquid Public Corporations With No Controlling Shareholders

Widely held public corporations that do not have a controlling shareholder exist in Canada, yet are more common in the United States.[9] The characteristics of these widely held corporations generally accord with the traditional, and perhaps still commonplace, conception of a corporation.[10] First, the ownership and management constituents retain their independent function, with little overlap.[11] For example, the shareholders own the corporation and benefit from any growth. However, the shareholders are generally not

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American and English commentary in these regards are equally applicable in Canada. See Brian R. Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988), 10 U.Pa.J. Int. Bus. L. 305 at 317-318; D. D. Prentice, "The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985" (1988) 8 Oxford J. of Legal Studies 55 at 60. Most foreign commentary will only address the stereotypical public corporation and closely held corporations. Little reference or exception will be made for public corporations that have illiquid shares and a dominant shareholder. The predominance of this type of public corporation in Canada, and the direct bearing its features have on the applicability of the oppression remedy, render this distinction worthy of note.

In the United States, the terms "close" corporation and "closely held" corporation are used interchangeably. They are considered synonymous for the purposes of this thesis. For a description of the common characteristics of a "close" corporation see Richard A. Posner, *Economic Analysis of Law*, 4th ed. (Boston: Little, Brown and Company, 1992) at 432; Christopher Blair Capel, "*Meiselman* v. *Meiselman*: 'Reasonable Expectations' Determine Shareholders' Rights" (1984) 62 N.C.L.R. 999 at 1003 and James D. Cox, *Quick Review: Corporations* (United States: Sum & Substance, 1993) at 42.

[9] MacIntosh, Holmes & Thompson, *supra*, note 4 at 87. The situation in England resembles that of the U.S. in this regard. "The typical large U.K. company does not have a majority shareholder": Brian R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997) at 465.

[10] Chapman, *supra*, note 3 at 173; Robert B. Thompson, "The Shareholder's Cause of Action for Oppression" (1993) 48 The Bus. Lawyer 699 at 700-702.

[11] Chapman, *ibid.* at 172-173.

directly involved in running the business and affairs of the corporation. Instead, the shareholders approve only fundamental corporate changes since they elect directors to oversee the operation of the business.[12]

A second characteristic associated with this type of public corporation is the high liquidity of the corporate shares. This is due, in part, to the listing of the corporate shares on the public stock exchange.[13] The public stock exchange provides a ready market of potential purchasers to whom a dissatisfied shareholder may sell its shares.[14] It also provides a current valuation for the shares.[15] The market valuation must be accurate to make the stock market a viable option. The nature of the investor affects the accuracy of the stock value as does the frequency with which such stock is traded.[16] If the stock market price for a corporation's shares reflects their true value, and if the shares are not thinly traded, selling one's shares on the stock market provides a reliable exit option. In these cases, it enables an aggrieved shareholder to dispose of its shares in a fairly cost efficient manner.[17]

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[12] See *CBCA*: s. 106(3); s. 189(3); s. 176; s. 183; s. 188; s. 192; s. 210; s. 211. The directors and any appointed officers are typically responsible for carrying on the day to day operations of the business.

[13] Prentice, *supra*, note 8 at 60; Thompson, *supra*, note 10 at 702.

[14] Vivien R. Goldwasser, "Shareholder Agreements - Potent Protection for Minorities in Close Corporations" (1994) 22 Aust. Bus. L. R. 265 at 270.

[15] Prentice, *supra*, note 8 at 60. This allows such shareholders to avoid the delay and expense closely held corporations are often faced with when the latter obtain a formal valuation.

[16] Daniels & MacIntosh, *supra*, note 5 at 877-879. Daniels and MacIntosh note that institutional investors, as opposed to retail investors, ensure more accurate pricing due to their higher level of monitoring. With respect to the frequency of trading, if a stock is infrequently traded, it is less likely to be sold in a timely manner for a price that reflects its true value. A price reduction is often inevitable to facilitate a sale. There may also be other reasons why the stock value is not accurate. For example, in some cases, an inaccurate valuation may occur because the oppressive act is reflected in the reduced value of the stock.

The liquidity of public corporate shares is further enhanced by the fact that the shares of public corporations often do not have any corporate transfer restrictions attached to them.[18] Consequently, a dissatisfied shareholder has the security of knowing it can sell its shares without obtaining any additional consents.[19]

The oppression remedy will have the least impact on this type of corporation. First, it is less likely for oppression to occur. Rarely will a shareholder expect to be involved in management.[20] As well, since there is no controlling shareholder, the corporation is "management controlled."[21] The absence of a controlling shareholder means that no one shareholder will have the power to influence management in accordance with such shareholder's preferences. It is more likely for conflicts between shareholders and management to occur as opposed to inter-shareholder conflicts.[22] Therefore the potential for shareholder disputes is reduced.[23] Also, shareholders with very liquid shares are less vulnerable to exploitation.[24]

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[17] Prentice, *supra*, note 8 at 60; J.A.C. Hetherington, "Problems, and Needs of the Close Corporation" (1969), U. Ill. L. F. 1 at 20-22. The stock market also helps to guard against managerial abuses and thereby provides additional protection to shareholders: Hetherington, *supra*, at 21; F. Hodge O'Neal & Robert B. Thompson, *O'Neal's Close Corporations*, 3rd ed. (New York, N.Y.: Clark Boardman Callaghan, 1985 - updated to 1997) at 8-67.

[18] Corporations listed on public stock exchanges are generally required to have shares that are freely transferable. As well, most shareholders of public corporations prefer to have freely transferable shares. The separation of ownership and management in public corporations minimizes the concern that a new shareholder be compatible: Cox, *supra*, note 8 at 41. The applicable securities legislation may, however, impose certain transfer restrictions.

[19] A common transfer restriction on shares of a closely held corporation is the requirement that the majority of directors consent to any disposition of the shares. Other transfer restrictions include: a right of first refusal in favour of the corporation and/or other shareholders or a restriction which requires a shareholder to sell its shares upon the happening of certain event.

[20] Peter A. Tannenbaum, "Shareholder Agreements - Oral Agreements in Close Quarters - *Penley* v. *Penley*" (1987) 22 Wake Forest L. Rev. 147 at 147; Prentice, *supra*, note 8 at 60; Cheffins, *supra*, note 8 at 317.

[21] MacIntosh, Holmes & Thompson, *supra*, note 4 at 87.

The second reason why the oppression remedy will have the least impact on this type of corporation is tied to the market exit option. If oppression does occur in a corporation that has highly liquid shares, an aggrieved shareholder will be more inclined to sell its shares on the stock market, rather than launch an oppression claim. In many cases, the stock market will be much more viable as it provides a quick and inexpensive way to dispose of one's shares.[25]

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[22] MacIntosh, Holmes & Thompson, *ibid.*

[23] MacIntosh, Holmes & Thompson, *ibid.*

[24] Hetherington notes that the inability of a shareholder in a closely held corporation to withdraw its investment at will confers a significant power on those in control of the corporation: Hetherington, *supra*, note 17 at 21. See also Thompson, *supra*, note 3 at 196-97; Cheffins, *supra*, note 8 at 317; Dennis Campbell & Sheila Buckley, eds. *Protecting Minority Shareholders* (London, Eng.: Kluwer Law International, 1996) at 615.

[25] Brian R. Cheffins, "An Economic Analysis of the Oppression Remedy: Working Towards a More Coherent Picture of Corporate Law" (1990) 40 U.T.L.J. 775 at 801. This remains the case even though the drafters of the prototype for the *CBCA* oppression remedy, the Dickerson Committee, attempted to make the commencement proceedings as simple as possible. See R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada*, vols. 1 & 2 (Ottawa: Information Canada, 1971) [hereinafter the *Dickerson Report*] at para. 13, 23. The Dickerson Committee was a federally appointed committee established to consider corporate law reform in Canada. See Jeffrey G. MacIntosh, "Minority Shareholder Rights in Canada and England: 1860-1987" (1989) 27 Osgoode Hall L.J. 561 at 639. Of course, the stock market will not be a viable alternative if the corporate stock is thinly traded or the stock market value for the shares does not accurately reflect the shares' true value. If the shares are very liquid, however, the stock will usually represent its fair value and enjoy heavy trading.

2. Illiquid Public Corporations That Have Controlling Shareholders

In Canada, illiquid public corporations that have a controlling shareholder are more common than liquid public corporations that do not have a controlling shareholder.[26] The existence of a controlling shareholder enhances the potential for shareholder conflicts, particularly between controlling and minority interests.[27] In contrast with a public corporation that does not have a controlling shareholder, the line between ownership and management becomes blurred. This is because controlling shareholders have the power to exert significant influence over management. This influence contributes to the vulnerability of minority shareholders due to the still relevant business judgment rule.[28] For example, controlling shareholders may influence management to assist in the alienation or exploitation of one or more minority shareholders. The business judgment rule may then be relied upon to insulate such corporate actions from court scrutiny.[29]

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[26] MacIntosh, Holmes & Thompson, *supra*, note 4 at 87.

[27] MacIntosh, Holmes & Thompson, *ibid.*

[28] Welling both recognizes and supports the continued relevance of the business judgment rule: Bruce L. Welling, *Corporate Law in Canada - The Governing Principles*. 2nd ed. (Toronto: Butterworths, 1991) at 510, 516, 519-520. Campion, Brown & Crawley, *supra*, note 3 at 234, note that the principle of majority rule remains a relevant corporate norm. See also Thompson, *supra*, note 3 at 196-197; O'Neal & Thompson, *supra*, note 17 at 1-124, 125; 8-67; Hetherington, *supra*, note 3 at 21 as well as *infra*, Section II.C.3.c.ii. of this Chapter Two which references numerous cases that support the continued relevance of the business judgment rule.

Supra, Chapter One, Section II.A., details the two principles (one of which is the principle of majority rule) that are represented by the business judgment rule. Of course, the dominance of these principles, and consequently, the business judgment rule, were weakened by the enactment of the statutory oppression remedy and certain other statutory shareholder protections including dissent and appraisal rights (*CBCA*, s. 190), the derivative action (*CBCA*, s. 239) and the relaxed ratification rule (*CBCA*, s. 242): Chapman, *supra*, note 3 at 179-180; Welling, *supra*, at 516 and generally, MacIntosh, *supra*, note 25.

[29] Chapman notes that in the case of a shareholder dispute, "the internal corporate process for dispute resolution, majority rule, may lead to harsh results": Chapman, *ibid.* at 172-73. Although Chapman is speaking in respect of closely held corporations, the

Curbing minority abuse by controlling shareholders is a central purpose of the oppression remedy.[30] The oppression remedy will consequently have a greater relevance for this type of public corporation as compared with a public corporation that does not have a controlling shareholder.[31] The separation of ownership and management in public corporations *without* controlling shareholders means it is unlikely that the business judgment rule will be used as a weapon to treat a minority shareholder unfairly.

The second distinguishing feature between the two types of public corporations reviewed herein is their difference in liquidity. While almost all public corporations have access to the stock market, it will not be a viable exit option if the stock market price for a public corporation's shares is below its fair market value[32] and/or if the stock is infrequently traded.[33] As well, the shares may become delisted and thus incapable of being sold on the

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comment is equally applicable to public corporations that have a controlling shareholder.

[30] *Dickerson Report*, *supra*, note 25 at para. 484.

[31] Daniels & MacIntosh note that regulatory law, in general, will have a greater role with public corporations that have a dominant shareholder and illiquid shares: Daniels & MacIntosh, *supra*, note 5 at 880.

[32] For example, in *Palmer* v. *Carling O'Keefe Breweries of Canada*, *supra*, note 3, the market value of the shares held by the complainant was below their redemption value. Therefore selling the shares on the market was not a viable alternative. If the market value cannot be relied upon, an independent valuation will often have to be obtained from business valuators. The expense involved with obtaining an independent valuation may be prohibitive in many situations. See the discussion, *infra*, in Section I.A.3. of this Chapter Two dealing with closely held corporations.

[33] Daniels & MacIntosh comment that a majority of the corporate stocks on the Toronto Stock Exchange are thinly traded and therefore have low liquidity: Daniels & MacIntosh, *supra*, note 5 at 877. "Thinly" traded is another way to describe a stock that is "infrequently" traded.

stock market.[34] All of these factors contribute to the illiquidity of a public corporation's shares.

Low liquidity increases a shareholder's vulnerability.[35] Increased vulnerability enhances the likelihood that oppression will occur. Low liquidity also renders it very unlikely that a shareholder will have a quick and inexpensive exit option. In this regard, a public corporation with illiquid shares will be in only a slightly better position than that of a closely held corporation.[36] The only appropriate course of action may be to proceed with an oppression claim.

3. Closely Held Corporations

A closely held corporation has several characteristics that render it distinct from public corporations. First, the shareholders of a closely held corporation often are, or expect to be, directors, officers and/or employees of a corporation.[37] The shareholders view their share holding as more than mere investment vehicles.[38] This includes both minority and majority shareholders. Therefore, the line between ownership and management is not merely blurred, but essentially disappears.[39]

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[34] For example, in *Westfair Foods Ltd.* v. *Watt*, *supra*, note 3, the class of shares held by the complainant had been delisted.

[35] See *supra*, note 24.

[36] The lack of transfer restrictions elevates the "liquid" status of these public corporations a bit above closely held corporations. Transfer restrictions are almost universal in closely held corporations and thereby render closely held shares that much more illiquid.

[37] Goldwasser, *supra*, note 14 at 266 n. 12; Thompson, *supra*, note 10 at 702; Campion, Brown & Crawley, *supra*, note 3 at 234; J. Anthony VanDuzer, "Who May Claim Relief From Oppression: The Complainant in Canadian Corporate Law" (1993) 25 Ottawa L.R. 463 at 468.

[38] Chapman, *supra*, note 3 at 172; Capel, *supra*, note 8 at 1003.

A shareholder does not have an automatic legal right to participate in corporate management or employment, regardless of whether the corporation is closely held or public. An exception to this general rule is if there are special circumstances warranting participation, such as an understanding amongst the shareholders to that effect.[40] This type of understanding forms the basis of a reasonable expectation of involvement and accordingly, if its not honoured, a legitimate basis for an oppression claim.

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[39] It is more likely for shareholders in closely held corporations to have expectations relating to corporate involvement for several reasons. First, some closely held corporations derive from pre-existing partnership structures that incorporate because they want to take advantage of the limited liability and preferential tax treatment available to corporations: Tannenbaum, *supra*, note 20 at 147; Capel, *ibid.* at 1004. Unfortunately, partners often fail to appreciate the additional legal implications of incorporating, including the effect it will have on their rights in relation to the business. As aptly noted by Lord Cross in *Ebrahimi* v. *Westbourne Galleries Ltd.* [1973] A.C. 360 at 386: "no one gave a moment's thought to the change in relative strength of their respective positions brought about by the conversion of the partnership into a company." This case is discussed in further detail, *infra*, in Section II.C.2. of this Chapter Two.

Even where there has been no pre-existing partnership, some or all of the parties may have agreed to a corporate structure with the expectation that the corporation will be governed by partnership principles. The limited liability associated with corporations entices parties to use the corporate form, regardless of the appropriateness of the corporate governance structure: Charles R. O'Kelley, Jr., "Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis" (1992) 87 Nw.U.L.Rev. 216 at 241. From a corporate governance standpoint, a partnership differs quite significantly from a corporation. One difference, which directly contributes to expectations of involvement, is that in a partnership, unless otherwise agreed, the partners all have a right to participate in the operations of the business from both a management and employment perspective. For example, see sections 7, 8 and 27 of the *Partnership Act*, R.S.A. 1980, c. P-2. In a corporation, unless otherwise agreed, the shareholders do not have this automatic right of involvement. Instead, the directors and officers are charged with running the business. The shareholders elect the directors (*CBCA*, s. 106(3)) and the directors elect the officers (*CBCA*, s. 121). Therefore shareholders who anticipate that partnership governance rules will apply are more likely to have expectations of corporate involvement beyond merely an investment capacity.

An additional factor which contributes to increased expectations of management involvement is that closely held corporations generally involve a much smaller number of shareholders than public corporations: Goldwasser, *supra*, note 14 at 266 n. 12. The reduced number of participants enhances the expectation and desire to be involved in the operation of the business. The desire for this involvement is further fuelled by the fact that most people prefer to have a say in how their money is spent.

The second distinguishing characteristic of closely held corporations is that their shareholders are more vulnerable, particularly minority shareholders. There are several reasons for this enhanced vulnerability. First, the overlap between share holdings and management means that the controlling shareholders will often be directly involved in the management and general operation of the closely held business. Therefore if the controlling shareholders are dissatisfied with a particular shareholder, they will have considerable opportunity to oppress such shareholder.[41] The business judgment rule could then serve to shield such actions from court involvement.[42] The potential for this vulnerability also exists in illiquid public corporations that have a controlling shareholder.[43]

Another reason for the enhanced vulnerability of closely held shareholders stems from the general illiquidity of closely held shares.[44] A closely held corporation is not listed or traded on any public stock exchange. This significantly restricts the liquidity of the shares[45] and essentially precludes a quick and inexpensive exit for an aggrieved shareholder.[46] The lack of access to a public market dramatically reduces the number of potential purchasers and precludes the availability of a market valuation for the shares. To value the shares, the parties must find another means of determining the share value. There are many methods of valuation available, however the appropriateness of the method depends on the specific business operations. Valuation is often an expensive process because it usually involves hiring a valuator who is specialized in this area.[47] Therefore, the absence of a viable market means that it is less likely a disgruntled shareholder will enjoy an inexpensive exit from a closely held corporation.[48]

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[40] *Keho Holdings Ltd.* v. *Noble* (1987), 52 Alta.L.R. (2d) 195 at 203, 38 D.L.R. (4th) 368, 78 A.R. 131 (C.A.).

[41] See *supra*, note 28 and accompanying text.

[42] See *supra*, notes 27, 28 and accompanying text.

[43] See *supra*, notes 26 to 29 and accompanying text.

[44] Cheffins, *supra*, note 25 at 800.

[45] Goldwasser, *supra*, note 14 at 266 n. 12; Thompson, *supra*, note 10 at 702.

The shares of a closely held corporation also typically have transfer restrictions attached to them, which further restrict the liquidity of the shares. These restrictions serve to control the admission and withdrawal of the shareholders. Transfer restrictions, coupled with the lack of a public market within which one can easily sell the shares, diminish the attractiveness of the shares from the perspective of a potential buyer.[49] The attractiveness of the shares is further reduced if the sale is of a minority interest[50] and if it has been prompted by dissension within the corporation.[51] These features all contribute to the illiquidity of closely held shares.

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[46] Hetherington, *supra*, note 3 at 21.

[47] The shareholders of the corporation may agree at the outset to a certain formula which is capable of calculation by the parties themselves. This does not necessarily avoid the valuation expense since a valuator's expertise should be sought to ensure the appropriateness of the formula.

[48] Cheffins, *supra*, note 25 at 800.

[49] Jeffrey G. MacIntosh, "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal" (1986) 24 Osgoode Hall L.J. 201 at 214.

[50] Cheffins, *supra*, note 25 at 800.

[51] O'Neal & Thompson, *supra*, note 17 at 9-4.

A third reason for the increased vulnerability of closely held shareholders stems from their involvement in the corporation in multiple capacities.[52] In addition to investing monetary capital, shareholders may have invested a significant amount of human capital with the expectation of continued employment and financial reward at some future time.[53] Compensation received from the corporation for a shareholder's employment duties may constitute their sole livelihood.[54] A shareholder that is unjustifiably dismissed from employment and frozen out of the corporate profits, may therefore lose not only its investment but also its livelihood and potentially years worth of unpaid effort.[55]

It is consequently most likely for an oppression claim to arise in the context of a closely held corporation as compared with either type of public corporation reviewed *supra*. The shareholders of closely held corporations are more likely to have reasonable, yet unrealized, expectations of management or employment involvement. These are legitimate grounds for an oppression claim. As well, closely held shareholders are more vulnerable to exploitation. This vulnerability increases the likelihood that oppression will occur. Since oppressed shareholders of closely held corporations do not have the option of selling their shares on the stock market, bringing an oppression claim may be their only recourse.

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[52] MacIntosh notes that shareholders of closely held corporations are more vulnerable if the corporate situation suddenly changes because they "are often significantly under diversified since a large part of their wealth (including their employment) is tied up in the enterprise." See MacIntosh, *supra*, note 49 at 214.

[53] Chapman, *supra*, note 3 at 172-173; Thompson, *supra*, note 10 at 702.

[54] Cox, *supra*, note 8 at 41.

[55] O'Neal & Thompson, *supra*, note 17 at 9-133. The recent case of *Stierman* v. *Genserve Ltd.* [1998] O.J. No. 2008 (Gen.Div.) at para. 40, recognized how loss of employment for a minority shareholder in a closely held corporation could leave such a shareholder powerless due to the controlling shareholders ability to manipulate corporate affairs to its advantage.

B. Circumstances Giving Rise to Potential Oppression Claims

The foregoing delineates the most relevant differences between closely held corporations and the two types of public corporations when considering the topic of oppression. This section will review, and in some places reiterate, several situations that are likely to give rise to an oppression claim.

A shareholder's reasonable, yet unrealized, expectation relating to corporate involvement beyond merely an investor capacity can form the basis of an oppression claim. It is more likely for a management or employment expectation to be considered reasonable if it is with respect to a closely held corporation.[56]

Another situation likely to give rise to an oppression claim is where a shareholder is "trapped" in a corporation. A minority shareholder becomes trapped if it is excluded from sharing in the corporate revenue[57] and is simultaneously unable to sell its shares due to their illiquidity.[58] The trap is commonly referred to as a "freeze out" or "squeeze out" and may be prompted by a variety of different motives including greed, personality clashes or disagreements over how the corporation should be run.[59] Therefore, in the context of the oppression remedy, a "freeze out" essentially means a situation where a shareholder is deprived of the economic value of its investment due to measures taken by the corporation or those integrally involved with the corporation.[60] In such circumstances, the only feasible recourse for a shareholder is to commence an oppression action.

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[56] See *supra*, Section I.A.3. of this Chapter Two.

[57] For example, if the profits and wealth are being siphoned off to other shareholders in the corporation.

[58] Hetherington, *supra*, note 17 at 21.

[59] F. Hodge O'Neal & Robert B. Thompson, *O'Neal's Oppression of Minority Shareholders*, 2nd ed. (Deerfield, Ill.: Clark Boardman Callaghan, 1985), vol. 1, at chapter 2.

Several concrete examples of a "freeze out" will better illustrate how a shareholder, particularly a minority shareholder, can become the victim of oppression. One example is a corporation that has an established policy of bonusing all of its profits to management on the basis that all of the shareholders are involved in management and therefore all would benefit. If one of the shareholders falls into disfavour, the shareholder may be dismissed from management. If the bonus policy does not change, all of the growth of the business would go to the other shareholders.[61] In addition to being excluded from the bonuses, the dismissed shareholder's shares would not increase in value since the profits are being distributed each year. If the shares are illiquid, the oppressed shareholder is unlikely to find a quick and inexpensive sale.[62] Failing a sale of the shares for an appropriate value, the shareholder is left trapped in the corporation and thus becomes a victim of the freeze out.

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[60] The terms "freeze-out" and "squeeze-out" are often considered synonymous from the perspective of the oppression remedy: O'Neal & Thompson, *ibid.* at 1-3 n. 2. O'Neal and Thompson's book *ibid.* provides a comprehensive analysis of numerous freeze-out/squeeze-out techniques. Technically, the term "squeeze-out" refers to a situation where a shareholder is forced to sell its shares against its will and generally for a price below their fair value. The term "freeze-out," when used in this thesis, is intended to include both "freeze-out" and "squeeze-out" situations.

[61] A common predicament of the minority shareholder is that it does not have enough share holdings or clout to force a change, either directly or indirectly, in the policy.

[62] Closely held shares are often considered to be illiquid because their shares cannot be sold on a public stock exchange. As well, closely held shares will inevitably have transfer restrictions attached to them, such as approval of the directors prior to a sale. Any requisite approvals in this regard may be intentionally withheld in the hopes of forcing the shareholder to sell the shares at a significantly reduced price to, or at the direction of, the corporation or those in control of the corporation: Thompson, *supra*, note 10 at 703-04.

The shares of public corporations may also have low liquidity if the corporate shares are thinly traded or delisted, or if the stock market value is lower than the shares' true value.

It is a popular business practice of closely held corporations to distribute most or all net revenue as salary or bonuses. This practice ensures there is as little profit as possible available for taxation. If a corporation adopts this practice, it may have to re-evaluate if a shareholder becomes dismissed from employment. In such circumstances, dismissing a shareholder from employment will essentially have the same effect as cancelling such shareholder's shares.[63]

Another method a corporation could use to effect a freeze out of a shareholder is by implementing a selective dividend policy. The policy may be to dividend the net profits to every shareholder except the one being frozen out.[64] If the shareholder's shares have low liquidity, the shareholder would not be receiving any return on its investment yet the investment would be trapped in the corporation. The foregoing examples represent a mere sampling of potential freeze out situations.

Certain protective measures may be taken by minority shareholders at the outset to reduce, although not eliminate, their vulnerability. One such measure is to ensure any rights and expectations are clearly delineated in a written contract, such as a unanimous shareholder agreement.[65] Many minority shareholders do not obtain this protection.[66] It can be expensive and time consuming. It is also difficult to foresee all of the different situations that may arise and enumerate everyone's rights in such circumstances.[67] In some situations, corporate management may be aware of a shareholder's misguided expectation, yet may choose not to clarify it at the outset so as not to risk losing the shareholder's investment. For these and other reasons, it is consequently unlikely that a minority shareholder will have all relevant expectations and understandings clearly set forth in writing.[68]

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[63] O'Neal & Thompson, *supra*, note 17 at 20 of 1997 Suppl.

[64] Capel, *supra*, note 8 at 1005.

[65] It is more likely that the expectation will be complied with if it is in writing. As well, the courts give heavy weight to written documentation in oppression cases to the extent that it is perceived to reflect the parties' true agreement and is not exploitive. See *infra*, Section II.C.3.c.i. of this Chapter Two.

[66] F. Hodge O'Neal, "Close Corporations: Existing Legislation and Recommended Reform" (1978) 33 Bus.Law. 873 at 881, 883-84; Hetherington, *supra*, note 3 at 22.

Written protection is even more unlikely in closely held corporations because they often develop from personal relationships.[69] In these cases, any illusions as to management involvement or other rights are not likely to be dispelled because the parties are often less inclined to spell out the terms of the arrangement. One reason may be because the shareholder with the expectation may not perceive the need for protection.[70] Alternatively, the shareholder may not want to suggest a lack of trust by requiring written

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Hetherington cites the results of an American study which showed that the vast majority of close corporations in the United States did not opt to use special contractual arrangements solely available to close corporation: Hetherington, *supra*, note 3 at 22 n. 35. Hetherington notes that putting too much emphasis on contractual arrangements "reveals a fundamental misunderstanding of the nature of close corporations": J.A.C. Hetherington and Michael P. Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem" (1977) 63 Va.L.Rev. 1 at 2 (see also at 36).

[67] Hetherington & Dooley, *ibid.* at 36.

[68] See *infra*, Chapter Four for a more in-depth explanation on these and other reasons why written protection is often not obtained at the outset.

[69] Tannenbaum, *supra*, note 20 at 150-51; Hetherington & Dooley, *supra*, note 66 at 36.

[70] O'Neal & Thompson, *supra*, note 17 at 8-85; Chapman, *supra*, note 3 at 172; Thompson, *supra*, note 3 at 199; Hetherington, *supra*, note 17 at 17. If the shareholder feels it cannot trust the majority shareholders or corporate management, the shareholder will likely forego the opportunity to invest in the corporation: Hetherington and Dooley, *ibid.* at 36.

confirmation[71] or may appreciate its weak bargaining position.[72]

In any event, although written documentation helps prove oppression by supporting the reasonableness of an expectation, it will not always preclude its occurrence. Oppression may still occur even where the expectation is set out in writing.

The oppression remedy applies to closely held corporations as well as to both types of public corporations discussed *supra*. The Dickerson Committee[73] did predict, however, that the oppression remedy would be applied more often when the corporation was closely held.[74] Several of the early Canadian oppression decisions confined the remedy to closely held corporations.[75] It is now well accepted that the oppression remedy is also available to public corporations,[76] yet there remains a tendency to consider it to be the exception. This stems from the commonly held view that a public corporation is widely held, with no dominant shareholder, and highly liquid. As discussed *supra*, most of the public corporations in Canada do not have these features.[77] Consequently it is important to recognize the need for the oppression remedy in public corporations that have a dominant shareholder and low liquidity.

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[71] Christopher A. Riley, "Contracting Out of Company Law: Section 459 of the *Companies Act*, 1985 and the Role of the Courts" (1992) 55 M.L.R. 782 at 787; Hetherington & Dooley, *supra*, note 66 at 36-37.

[72] Hetherington, *supra*, note 17 at 17-18; O'Neal, *supra*, note 66 at 884.

[73] See *supra*, note 25.

[74] *Dickerson Report*, *supra*, note 25 at para. 484.

[75] For example, *Ferguson* v. *Imax Systems Corp.* (1983), 150 D.L.R. (3d) 718, 43 O.R. (2d) 128 (C.A.), rev'g 134 D.L.R. (3d) 519, 38 O.R. (2d) 59, (rev'g 12 B.L.R. 209), leave to appeal refused 52 N.R. 317*n*, 2 O.A.C. 158*n* and *Mason* v. *Intercity Properties Ltd.* (1987), 38 D.L.R. (4th) 681, 37 B.L.R. 6 (C.A.), leave to appeal to S.C.C. refused 42 D.L.R. (4th) viii., 62 O.R. (2d) ix., 87 N.R. 73*n*.

[76] Cheffins, *supra*, note 8 at 317-319. The following oppression cases involved widely held corporations: *Westfair Foods Ltd.* v. *Watt*, *supra*, note 3; *AMCU Credit Union Inc.* v. *Olympia & York Dev. Ltd.* (1992), 7 B.L.R. (2d) 103 (Ont.Gen.Div.); *Themadel Foundation* v. *Third Canadian Investment Trust Ltd.* [1998] O.J. No. 647 (C.A.) [hereinafter *Themadel*]; *Aquino* v. *First Choice Capital Fund Ltd.* [1995] 5 W.W.R. 608, 130 Sask.R. 252 (Q.B.) add'l reasons at (1995) 135 Sask.R. 7 (Q.B.) and (1996) 143 Sask.R. 81 appeal all'd in part with respect to type of order [1997] 3 W.W.R. 143, 148 Sask.R. 288 (C.A.); *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.* (1991), 80 D.L.R. (4th) 359, 3 B.L.R. (2d) 237 (Sask.C.A.); *Sparling* v. *Javelin International Ltd.* [1986]

The above analysis is important to a consideration of the oppression remedy. It sensitizes one to the potential vulnerabilities that may exist in the corporate environment, particularly when the corporation is either a closely held corporation or an illiquid public corporation with a dominant shareholder. This sensitivity helps direct the application of the oppression remedy towards the appropriate conduct. It therefore assists in the ascertainment of the remedy's proper parameters. Against this backdrop, it is now worthwhile to analyse the judicial application of the oppression remedy in Canada since its enactment.

II. JUDICIAL APPLICATION OF THE STATUTORY OPPRESSION REMEDY

A. General

The wording of the statutory oppression remedy is very broad and therefore confers a

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R.J.Q. 1073 (Que. S.C.); *Palmer* v. *Carling O'Keefe Breweries of Canada Ltd.*, *supra*, note 3. In *820099 Ontario Inc.* v. *Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at 123 (Ont.Gen.Div.) aff'd (1991), 3 B.L.R. (2d) 113 (Ont.Div.Ct.) [hereinafter *Ballard*], the court agreed, in *obiter*, that the remedy was applicable to widely held corporations.

[77] See *supra*, note 5 and accompanying text.

wide discretion on the courts to determine its appropriate ambit.[78] The Dickerson Committee,[79] which drafted the prototype for the federal oppression legislation, provided only minimal guidance to the courts. In this regard, the Dickerson Committee simply noted that the standard of conduct proscribed by the federal oppression remedy is aptly described in the following comment, made by Lord Cooper in an early English case:[80]

> ...the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[81]

In a similar vein, the Alberta Law Reform Institute stated that:

> The three criteria [of oppression, unfair disregard and unfair prejudice] probably, however, come down to one criterion which, so far as a shareholder is concerned is this: Is the conduct unfair to the shareholder? If it is, he should have a remedy. The section does not tell the courts much about what is "unfair," nor does it tell the courts how to choose between the various remedies which the section makes available; it leaves them

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[78] The Dickerson Committee (*supra*, note 25) offered several reasons in support of such a broad delegation: see *supra*, Chapter One, Section II.C. A paramount reason was that because the misconduct could manifest itself in many different ways, it would be impossible to delineate a specific list of proscribed actions that was sufficiently comprehensive yet not unduly restrictive. The Alberta Law Reform Institute (formerly called the Institute of Law Research and Reform), which reviewed the state of Alberta's corporate law in the late seventies, similarly noted that:

> ...the circumstances in which companies and their shareholders find themselves are subject to almost infinite variation, and legislation which would try to provide for them all would necessarily be almost unbearably complex and would be unlikely to provide a net which would catch only the unscrupulous.

See Edmonton Institute of Law Research and Reform, *Report No. 36 Proposals for a New Alberta Business Corporations Act*, vol. 1 (Edmonton: Institute of Law Research and Reform, 1980) [hereinafter *Alberta Report*] at 142.

[79] *Ibid.*

[80] *Dickerson Report*, *supra*, note 25 at para. 485.

[81] *Elder* v. *Elder and Watson Ltd.* [1952] S.C. 49 at 55 (Sc. Ct. Sess.).

free to apply broad equitable standards.[82]

The balance of this Chapter Two will analyze the judicial treatment of the statutory oppression remedy in Canada since its enactment. The focus of the analysis will be on the particular tests or principles used by the courts when assessing the applicability of the remedy.

A review of the Canadian case law from the enactment of the federal oppression remedy to and including 1998 supports the proposition that there were two main stages in its judicial application. The first stage was dominated by a judicial reluctance to confine the courts to any specific rules.[83] Instead, the general notion of fairness governed with particular emphasis on the need for a case by case assessment. The courts' approach during this stage is described herein as the "general fairness" test. This first stage lasted from approximately 1975, which is the year in which the federal statutory oppression remedy was first enacted, to and including 1990. The second stage, which began in 1991 and continues to the present, is characterized by the courts' increased focus on a complainant's expectations and the growing acceptance and refinement of the "reasonable expectations" test. The fairness notion was not abandoned during the second stage. Rather, the "reasonable expectations" test was used to help assess whether the conduct was fair. Each of these two stages are discussed in detail below.[84]

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[82] *Alberta Report*, *supra*, note 78 at 141-42.

[83] Cheffins, *supra*, note 8 at 313, 321.

[84] The author has categorized the judicial application of the oppression remedy in accordance with the overriding tests the courts have adopted to assess the remedy's application. The categorization resulted in two main periods or stages, each of which reflected a general consensus as to the appropriate test. This is a general categorization gleaned from a review of the case law, therefore there are some oppression cases that do not fit exactly within the categorizations described herein.

There are also many other ways to categorize the cases. Several examples include categorizations based on: the type of conduct, the type of corporation, whether oppression

B. First Stage: 1975 - 1990

1. The "General Fairness" Test

An examination of the Canadian judicial treatment of the statutory oppression remedy, from its enactment to approximately 1990, reveals that three main elements or principles governed its application.[85] While certainly not every case decided during this time expressly or even impliedly adopted all three elements, many of the cases accepted at least one and often more. Therefore the cases, taken as a whole, tend to support these three features as the dominating principles, which hereafter will be referred to as the "general fairness" test.

The first principle of the "general fairness" test is the rule that the conduct must accord with general standards of fairness. Second, when making the assessment as to what is fair, the remedial nature of the oppression remedy must be kept in mind such that it be given a broad and liberal interpretation. The third element, which is closely related to the first, is the recognition that legally authorized conduct could violate the oppression remedy if such conduct did not accord with the equitable principles of fairness. In short, that equitable principles could supersede legal rights.

With respect to the first principle, the application of the oppression remedy in the early case law relied heavily on the notion of fairness in deciding whether a particular situation warranted the application of the remedy. This was consistent with the approach

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was found, the nature of the relief granted or the type of complainant. The author has chosen this particular categorization as the most appropriate since it aptly contributes to a major focus of this thesis. This focus being the ascertainment of the structure and content of the current "reasonable expectations" text.

[85] Rather than footnote each of these features, please refer to the immediately following text which discusses these features in more detail.

advocated by both the Dickerson Committee and the Alberta Law Reform Institute.[86] While the grounds of oppression, unfair prejudice and unfair disregard constituted three separate grounds upon which one may base a claim for oppression, the courts, in general, tended to focus less on the specific grounds and more on the general requirement of fairness.[87] Unfairness essentially became a synonym for the oppression remedy as it represented a common element of all three grounds.[88]

There were, however, some attempts in the early cases to define what was meant by each of these grounds. With respect to the "oppression" ground, the Canadian cases have generally accepted the definitions cited in previous English cases.[89] The leading English decision in this respect is the case of *Scottish Co-Operative Wholesale Society Ltd.* v. *Meyer*,[90] which was the first oppression case to go before the House of Lords. This decision included the following definitions of oppression, both of which have been accepted by the Canadian courts:[91]

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[86] See *supra*, notes 80, 82 and accompanying text.

[87] Professor Waldron notes that it was well accepted that the oppression remedy encompassed a "general range of unfair conduct": Mary Anne Waldron, "Corporate Theory and the Oppression Remedy" (1981-82), 6 Can. Bus. L.J. 129 at 151. The specific type of conduct that was to fall within each of the three grounds remained uncertain. The courts had a tendency "to merge the two concepts of oppression and unfairness into what is essentially a corporate fairness doctrine which is highly fact and case specific": E.A. Cronk and Paul F. Monahan, "The Oppression Remedy Revisited" (1989-90) 11 Adv. Q. 393 at 404.

[88] Karen C. Ulmer, "Business Issues: The Oppression Remedy" (1989) 53 Sask L. Rev. 209 at 212, 216-217.

[89] Cheffins, *supra*, note 8 at 320; M. Ian Giroday, "The Oppression Remedy" in the book *Shareholders' Remedies* (Vancouver: C.L.E. of B.C., 1996) 2.2 at 2.2.04; Jeffrey G. MacIntosh, "The Retrospectivity of the Oppression Remedy" (1987-88) 13 Can. Bus. Law J. 219 at 221.

[90] [1958] 3 All E.R. 66; [1959] A.C. 324 (H.L.) [hereinafter *Scottish Co-Operative* cited to E.R.]

(a) Conduct that is "burdensome, harsh and wrongful" (Viscount Simonds);[92] and

(b) Conduct that amounts to a "lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members" (Lord Keith).[93]

With respect to the grounds of "unfair prejudice" and "unfair disregard," it was well accepted from the outset that these two grounds catch a wider scope of conduct than the ground of oppression.[94] In addition, the focus of the courts' inquiry, when dealing with the oppression ground, is often on the motive and type of conduct. In contrast, when considering the grounds of unfair prejudice and unfair disregard, the courts' focus tended to shift to the effect of the conduct on the complainant, as opposed to the nature of the conduct.[95]

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[91] Cheffins, *supra*, note 8 at 320.

[92] *Scottish Co-Operative*, *supra*, note 90 at 71. This definition was referred to in the following Canadian cases: *Burnett* v. *Tsang* (1985), 29 B.L.R. 196, 37 Alta.L.R. (2d) 159 (*sub. nom. Re Cucci's Restaurant Ltd.; Burnett* v. *Tsang*), 61 A.R. 219 (Q.B.); *Redekop* v. *Robco Construction Ltd.* (1978), 89 D.L.R. (3d) 507 (B.C.S.C.); *Re Nat. Building Maintenance Ltd.* [1971] 1 W.W.R. 8 (B.C.S.C.), aff'd (*sub. nom. National Building Maintenance Ltd.* v. *Dove*) [1972] 5 W.W.R. 410 (B.C.C.A.); *Cairney* v. *Golden Key Holdings Ltd. (No. 1)* (1987), 40 B.L.R. 263 (B.C.S.C.); *Miller* v. *F. Mendel Holdings Ltd.* [1984] 2 W.W.R. 683, 30 Sask. R. 298 (Q.B.); *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.* (1988), 60 Alta. L.R. (2d) 122, 40 B.L.R. 28 (Q.B.), rev'd on other grounds (1989), 71 Alta. L.R. (2d) 61, 45 B.L.R. 110 (C.A.); *Abraham* v. *Inter Wide Investments Ltd.* (1985), 20 D.L.R. (4th) 267, 51 O.R. (2d) 460, 30 B.L.R. 177 (H.C.J.), supplementary reasons at 55 D.L.R. (4th) 377, 62 O.R. (2d) 684, var'd as to valuation (1988), 55 D.L.R. (4th) 377, 66 O.R. (2d) 684.

[93] *Scottish Co-Operative*, *ibid.* at 86. This definition, or portions thereof, were referred to in the following Canadian cases: *Redekop* v. *Robco Construction Ltd.*, *ibid.* (although it applied V. Simonds definition); *Keho Holdings Ltd.* v. *Noble*, *supra*, note 40; *Burnett* v. *Tsang*, *ibid.*; *Cairney* v. *Golden Key Holdings Ltd. (No. 1)*, *ibid.*; *Nystad* v. *Harcrest Apartments Ltd.* (1986), 3 B.C.L.R. (2d) 39 (S.C.); *Camroux* v. *Armstrong* (1990), 47 B.L.R. 302 (B.C.S.C.); *Eiserman* v. *Ara Farms Ltd.* (1988), 52 D.L.R. (4th) 498; [1988] 5 W.W.R. 97, 67 Sask. R. 1 (Sask. C.A.); *Diligenti* v. *RWMD Operations Kelowna Ltd. (No. 1)* (1976), 1 B.C.L.R. 36 [hereinafter *Diligenti*]; *Stech* v. *Davies* [1987] 5 W.W.R. 563, 53 Alta. L.R. (2d) 373 (Q.B.).

[94] MacIntosh, *supra*, note 89 at 221-22 and MacIntosh, *supra*, note 25 at 625. For example, see *Nystad* v. *Harcrest Apartments Ltd.*, *ibid.*; *Journet* v. *Superchef Foods Inds. Ltd.* (1984), 29 B.L.R. (206) (Que. S.C.); *Abraham* v. *Inter Wide Investments Ltd.*, *supra*, note 92; *O'Connor* v. *Winchester Oil & Gas Inc.* (1986), 69 B.C.L.R. 330 (S.C.); *Mason* v. *Intercity Properties Ltd.*, *supra*, note 75; *Miller* v. *F. Mendel Holdings Ltd.*, *supra*,

Although "the meaning of the phrases "unfair prejudice" and "unfair disregard" have not been exhaustively described,"[96] when defined, the courts have often relied on dictionaries as the source of these definitions.[97] For the most part, little distinction was made in the cases between the grounds of "unfair prejudice" and "unfair disregard."[98] The definitions emphasized conduct that was generally "unjust" or "inequitable"; thereby importing the

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note 92. *Diligenti, ibid.* was the first decision in which the British Columbia Supreme Court was required to consider the new ground of "unfair prejudice" pursuant to the *Companies Act (1973)*, S.B.C. 1973, c. 18, s. 221. In this case, the court acknowledged that the normal rules of statutory interpretation would suggest that adding the phrase "unfair prejudice" signified the legislature's intention to expand the meaning beyond merely oppression: *Diligenti, ibid.* at 44-46.

[95] Cheffins, *supra*, note 8 at 320-21; Ulmer, *supra*, note 88 at 215 (who cites *Eiserman* v. *Ara Farms Ltd.*, *supra*, note 93 and *Nystad* v. *Harcrest Apartments Ltd.*, *ibid.*); Campion, Brown & Crawley, *supra*, note 3 at 232.

[96] Cronk & Monahan, *supra*, note 87 at 403.

[97] Cheffins, *supra*, note 25 at 779. For example, see *Diligenti*, *supra*, note 93 at 46, where the court referred to the dictionary definitions of "unfair" and "prejudicial" in the *Shorter Oxford English Dictionary* (3rd ed.) and noted that these definitions "support the instinctive reactions that what is unjust and inequitable is obviously unfairly prejudicial." This definition was subsequently accepted by numerous Canadian cases including *Eiserman* v. *Ara Farms Ltd.*, *supra*, note 93 and *Miller* v. *F. Mendel Holdings Ltd.*, *supra*, note 92.

[98] Ulmer, *supra*, note 88 at 212 & 216. For example, see *R.* v. *Sands Motor Hotel Ltd.* (1984), 28 B.L.R. 122 (Sask.Q.B.); *Abraham* v. *Inter Wide Investments Ltd.*, *supra*, note 92; *Miller* v. *F. Mendel Holdings Ltd.*, *ibid.* However, see *Mazzotta* v. *Twin Gold Mines* (1987), 37 B.L.R. 218 (Ont.H.C.J.), which was decided on the basis of unfair disregard, and *Stech* v. *Davies*, *supra*, note 93, which defined "unfairly disregards the interests of" as "to unjustly or without cause...pay no attention to, ignore or treat as of no importance the interests of" a shareholder or other complainant.

notion of fairness.[99] Therefore even the attempts to define the individual grounds of oppression pointed one back to the general proposition that the statutory oppression remedy required the conduct to accord with the principles of fairness.

The second feature of the "general fairness" test which pervaded the early statutory oppression cases was the recognition by the courts that the statutory oppression remedy should be given a broad and liberal interpretation.[100] In contrast with the courts' historical reluctance to interfere in corporate law matters, they adopted a much more interventionist approach with respect to the application of the oppression remedy.[101] The courts were reluctant to restrict the remedy and thus did not delineate specific principles to help guide the determination as to what is fair.[102] Instead, the tendency of the courts was to explain away each case on its facts, providing little insight as to what principles were directing the invocation of the statutory oppression remedy.[103] One legal scholar aptly noted as follows:

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[99] See *Vedova* v. *Garden House Inn Ltd.* (1985) 29 B.L.R. 236 at 240 (Ont.H.C.J.) which held that the word "unfair" connotes "an obligation to act equitably or impartially in the exercise of power or authority." The case was incorrect, however, in limiting the availability of the oppression remedy to minority shareholders.

[100] Ulmer, *supra*, note 88 at 210. See also *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92; *Nystad* v. *Harcrest Apartments Ltd.*, *supra*, note 93; *Abraham* v. *Inter Wide Investments Ltd.*, *supra*, note 92; *Redekop* v. *Robco Construction Ltd.*, *supra*, note 92; *Stech* v. *Davies*, *supra*, note 93; *Keho Holdings Ltd.* v. *Noble*, *supra*, note 40; *Ferguson* v. *Imax Systems Corp.*, *supra*, note 75; *Mason* v. *Intercity Properties Ltd.*, *supra*, note 75. The oppression remedy is considered to be remedial legislation and the normal canons of statutory interpretation require a broad and liberal interpretation of remedial provisions: Cronk & Monahan, *supra*, note 87 at 398.

[101] Chapman, *supra*, note 3 at 179; Cheffins, *supra*, note 8 at 328-29. Jeffrey G. MacIntosh noted that the courts have "shown far less timidity than would have once been the case in objectively reviewing the declared business purposes or fairness of the transaction...": MacIntosh, *supra*, note 25 at 642.

But note that some of the early cases expressed concern over the remedy being used as a weapon by the minority to "extort decisions from the majority": *Mason* v. *Intercity Properties Ltd.*, *ibid.* at O.R. (2d) 648. As well, there were several attempts in the case law to impose unnecessary limitations on the statutory oppression remedy such as requiring bad faith or restricting the application of the remedy to closely held corporations. For example, see *Ferguson* v. *Imax Systems Corp.*, *ibid.* It is now clear that neither operate as prerequisites for the application of the remedy, although both may be relevant to a "reasonable expectations" inquiry.

> Perhaps wary that any general statement as to the circumstances in which a court could act might be viewed by other courts as being all inclusive or limiting, the first decisions attempted to deal with cases on an individual, fact-specific basis with little attempt to synthesize general guidelines as to the remedy's applications. Afraid of rigid rules, little or no guidance as to the practical application of the remedy was provided.[104]

The third feature of the "general fairness" test revealed in these early cases is the recognition by the courts that the oppression remedy allowed, in the appropriate circumstance, equitable principles to supersede legal rights.[105] A court had to inquire beyond whether one had the legal right to pursue an action and consider whether the exercise of such legal right accorded with equitable considerations. Therefore equitable principles were to guide the settlement of intra-corporate disputes.[106]

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[102] Cheffins, *ibid.* at 321-23.

[103] For example, see *Ferguson* v. *Imax Systems Corp.*, *ibid.*; *Mason* v. *Intercity Properties Ltd.*, *ibid.* at O.R. (2d) 648. See *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92 for an exception to this general trend. In this case, although J. McDonald held that each case will turn on its own facts, his decision differed from many of the other cases decided during this first stage in that he wrote a comprehensive analysis on the history of the oppression remedy, on the various principles to be balanced in the application of the remedy and on the specific considerations to be addressed in determining whether the oppression remedy should be applied.

[104] Chapman, *supra*, note 3 at 181.

[105] MacIntosh, *supra*, note 25 at 632. For example, see *Ferguson* v. *Imax Systems Corp.*, *supra*, note 75 at O.R.(2d) 137; *Keho Holdings Ltd.* v. *Noble*, *supra*, note 40 at Alta L.R. (2d) 201.

[106] *Keho Holdings Ltd.* v. *Noble*, *ibid.* at Alta L.R. (2d) 201.

Although the "general fairness" test provided only minimal guidance as to the type of conduct that should fall within the purview of the oppression remedy, the early courts did begin to focus on the relationships between the parties and shareholder expectations.[107] This eventually led to the second stage of the judicial interpretation of the remedy which is marked by the courts' general acceptance of what is now commonly referred to as the "reasonable expectations" test. Prior to reviewing this second stage in any detail, several prominent cases from the first stage will be reviewed.

2. Prominent Oppression Remedy Cases Decided During the First Stage

This following cases provide concrete examples as to how the courts approached the early application of the oppression remedy. An often cited case decided during this first stage is the case of *Diligenti*.[108] In this case, the applicant was one of four equal shareholders of a corporation. The corporation was intended to be set up on a partnership basis and therefore all four shareholders were also directors of the corporation. Dissention arose amongst the shareholders which resulted in the applicant being ousted as a director and relieved of any management responsibilities. The applicant brought an application pursuant to the British Columbia statutory oppression provision claiming that the exclusion from management and certain other facts constituted oppressive conduct.

The statutory provision in British Columbia, in contrast with the federal statutory oppression remedy, required that a shareholder be affected in his capacity as a shareholder. A strict reading of this provision would suggest that exclusion from management would not be sufficient grounds since a right to participate in management is not generally considered to be an automatic right of shareholders. The court held, however, that in certain situations, the right to participate in management may be an additional right to which a shareholder is entitled, regardless of whether the corporate constitution expressly provides for it. This case was considered to be one such situation since the shareholders originally intended the corporation to be set up similar to a partnership with all shareholders being involved in management. Therefore the court found that the applicant's exclusion from management constituted unfairly prejudicial conduct. This case was the first reported Canadian case to discuss the meaning of the phrase "unfairly prejudicial." As well, the decision incorporated all three elements of the "general fairness" test.

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[107] MacIntosh, *supra*, note 25 at 632. See also MacIntosh, *supra*, note 25 at 632 n. 268 for a list of relevant cases.

[108] *Supra*, note 93.

The case of *Jackman* v. *Jackets Ent. Ltd.*[109] provides an interesting contrast to the *Diligenti* case in terms of the court's approach to the discussion of the oppression remedy. Interestingly enough, both were decided by the same judge. The *Diligenti* case discussed the history of the statutory oppression remedy in British Columbia as well as the relevant principles to consider when assessing whether the remedy should apply. In the *Jackman* case, the most the court said in this respect was that once oppression is found, the appropriate remedy must again take into account the nature of the relationship between the parties as well as the purpose for which the company was set up.[110] This approach reflects a common approach found in the oppression cases decided during the first stage. The focus was typically on the facts of the case with little or no reference to the ambit of the oppression remedy or the appropriate test to apply.

The *Jackman* case involved a company which had two shareholders, one of whom was a significant majority shareholder. The application for oppression was brought by the minority shareholder. The application was primarily based on the following conduct:

(a) The failure of the majority shareholder to hold annual general meetings, provide annual financial statements or consult the minority shareholder on the running of the business.

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[109] (1977), 4 B.C.L.R. 358, 2 B.L.R. 335 (S.C.) [hereinafter *Jackman* cited to B.C.L.R.].

[110] *Jackman, ibid.* at 361.

(b) The fact that the company, under the direction of the majority shareholder, borrowed additional funds, on the security of the company, from an independent lender. The bulk of these funds was then loaned, on an unsecured basis, to an associated company of which the majority shareholder owned all of the shares.

The court held that, in contrast with the *Diligenti* case, the circumstances did not support the minority shareholder's claim that she had a right to participate in management. The oppression provision was consequently not violated by failing to allow the minority shareholder to be a director or to consult with the minority shareholder on the running of the business. The remaining grounds were, however, held to violate the oppression provision. The right to annual general meetings and financial statements were part of a shareholder's bundle of rights such that failure to provide same amounted to oppression. The unsecured loan to the related company, which was of no benefit to the minority shareholder yet would benefit the majority shareholder, was also held to constitute unfairly prejudicial or oppressive conduct. Although the relief sought by the applicant was the purchase of her shares, the court held that the conduct was not sufficient to warrant such an order. Instead, the court ordered the loan to be adequately secured and the interest payments to be high enough to offset any losses in this regard. The court also ordered the company to comply with the terms of the governing corporate statute.

The Ontario Court of Appeal case of *Ferguson* v. *Imax Systems Corp*[111] is similar to the *Diligenti* case in that both imported all three elements of the "general fairness" test.[112]

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[111] *Supra*, note 75 [hereinafter *Ferguson* cited to O.R. (2d)].

[112] *Ferguson*, *ibid.* at 137. The decision, by Brooke J.A., references common law support for the principle that minorities are entitled to be treated fairly [see *Allen* v. *Gold Reefs of West Africa, Ltd.*[1900] 1 Ch. 656 at 671; *Goldex Mines Ltd.* v. *Revill* (1974), 7 O.R. (2d) 216 at 224, 54 D.L.R. (3d) 672 at 680]. The court, however, goes on to state that the statutory oppression remedy is more than simply a codification of the common law.

This case involved what has been previously referred to herein as a "freeze-out."[113] The applicant was both a minority shareholder and, initially, an active participant in the running of a closely-held corporation. Her husband was also a minority shareholder in the corporation as well as one of three directors. Although the corporation's financial difficulties prevented her from being adequately compensated, her participation in the business continued until shortly after she separated from her husband. At this time, she was discharged by the company. The applicant remained a shareholder and although the financial position of the corporation improved significantly over the next several years, the applicant did not receive the benefits of this growth. The corporation, under the influence of the applicant's ex-husband, had adopted a policy not to declare any dividends until the applicant sold her shares. At the same time, substantial salaries and expenses were being paid to, and incurred by, the directors. Effectively, the conduct prevented the applicant from participating in the financial growth of the corporation. As well, the corporation proposed a reorganization which, if implemented, would convert the applicant's shares from non-redeemable to redeemable shares and thereby allow the applicant to be bought out.

The court held that the proposed reorganization was the "culminating event in a lengthy course of oppressive and unfairly prejudicial conduct"[114] to the applicant. The court granted the applicant the relief sought which was an injunction to prevent the corporation from ever implementing the reorganization.

The Alberta Court of Appeal, in the case of *Keho Holdings Ltd.* v. *Noble*,[115] agreed with the principles relating to fairness set forth in the *Ferguson* case. These principles included the three elements comprising the "general fairness" test.[116] The applicants in this case were several minority shareholders who felt that they were the victims of oppression as a result of the following conduct:

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[113] See *supra*, Section I.B. of this Chapter Two.

[114] *Ferguson*, *supra*, note 75 at 138.

[115] *Supra*, note 40 [hereinafter *Keho* cited to Alta L.R.].

(a) They did not have representation on the board of directors and thus were excluded from participating in management.

(b) The majority shareholder, who was also a director, had caused the corporation to grant him a stock option to purchase an additional portion of shares in the corporation at a price well below fair market value.

(c) The majority shareholder, without consultation with the rest of the directors, caused the corporation to borrow money from its lender which money was then lent, on an unsecured basis, to a corporation controlled by the majority shareholder.

The purpose of the corporation was to invest in two public companies. The approximately twenty original shareholders had no previous business associations with each other.

The court did not accept the applicants' claim that the shareholders had a relationship analogous to a partnership. On that basis, the court held that the applicants' exclusion from management was not oppressive since there was nothing to justify their entitlement to same. The stock option was, however, held to be both oppressive and unfairly prejudicial. The exercise of the option by the majority shareholder would dilute the amount of the shares held by the minority shareholders and thereby divert company assets to the majority shareholder at the expense of the minority shareholders. The loan, which was also to the prejudice of the minority shareholders, was held to be unfairly prejudicial. The majority shareholder, in granting the loan, treated the corporation as if it was his personal domain.[117] Rather than grant the requested liquidation order, the court ordered that the stock option be cancelled and that the loan either be repaid or adequately secured, within thirty days.[118]

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[116] *Keho*, *ibid.* at 201.

There were many more oppression decisions decided during this first stage, however it is unnecessary to specifically consider all of them herein. The review of the foregoing cases provides concrete illustrations of the application of the "general fairness" test. In addition, these cases represent fairly typical examples of the types of situations which may give rise to an oppression claim.

C. Second Stage: 1991 to Present

1. Introduction to the "Reasonable Expectations" Test

In recognition of the need for greater direction, the "general fairness" approach began to erode in favour of a more specific test. This led to the development and general acceptance of the "reasonable expectations" test, which characterizes the second stage of the Canadian judicial treatment of the statutory oppression remedy.[119] Simply put, the "reasonable expectations" test focuses on the basis of the relevant parties' association. To determine this, a court will have regard to many different factors insofar as they reveal the expectations and understandings of the various corporate participants. The list of expectations that may be protected by the oppression remedy is open-ended.[120]

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[117] *Keho*, *ibid.* at 203-04. The court cited *Jackman*, *supra*, note 109 as being a persuasive authority.

[118] *Keho*, *ibid.* at 209.

[119] Chapman, *supra*, note 3 at 186-88. As early as 1993, VanDuzer recognized the growing trend in this regard. See VanDuzer, *supra*, note 37 at 481.

[120] An unrealized expectation relating to participation in management is a common ground of complaint in an oppression claim.

The judicial approach in the second stage was similar to the approach in the first stage in that the courts gravitated towards using one overriding test rather than a separate test for each of the three grounds of unfair prejudice, unfair disregard and oppression. Although the courts recognized that the grounds were not synonymous, the focus was less on their differences and more on their common denominator. The early statutory oppression cases clearly established that the common denominator was fairness. The second stage cases went further by recognizing that this goal of fairness could be most appropriately ascertained through an assessment of the complainant's reasonable expectations. Therefore the "reasonable expectations" test did not replace the well accepted proposition that the oppression remedy requires the conduct to accord with equitable standards of fairness. Rather, the "reasonable expectations" test complemented this notion by providing a test which could help assess what is fair in a particular situation.[121]
While the courts have accepted the "reasonable expectations" test as the governing test, they have been reluctant to clarify what the test entails and the relevance of different situational factors. Prior to analysing the "reasonable expectations" test in more detail, the *Ebrahimi* v. *Westbourne Galleries Ltd.* case[122] will be reviewed. This case played a significant role in the Canadian acceptance of a "reasonable expectations" test for the oppression remedy.

2. *Ebrahimi* v. *Westbourne Galleries Ltd.*[123]

Use of a "reasonable expectations" test in oppression cases received academic support at least as early as 1969.[124] Around this time, there was also implicit judicial support for an expectations test in several American cases.[125] However, it was the English case of *Ebrahimi*,[126] a 1972 decision of the House of Lords, which served as the initial guiding force in the acceptance and application of an "expectations" analysis for Canadian oppression cases.[127]

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[121] Campion, Brown & Crawley, *supra*, note 3 at 249, 253.

[122] *Supra*, note 39.

[123] *Ibid.* [hereinafter *Ebrahimi*].

[124] Allen B. Afterman, "Statutory Protection For Oppressed Minority Shareholders: A Model for Reform" (1969) 55 Va. L.R. 1043 at 1063.

The *Ebrahimi* case involved a private corporation that had three shareholders. These three shareholders were also the sole directors. Prior to setting up the corporation, the petitioner and one of the shareholders had been business partners for many years. Upon incorporation, the other shareholder's son joined the business, thereby becoming the third shareholder. Conflict arose between the petitioner and the other two shareholders which resulted in the petitioner being removed from his positions as director and officer of the corporation. The petitioner sought an order for the purchase of his shares on the ground of oppression or alternatively, for a winding up of the corporation on the "just and equitable" ground. The petitioner had several grounds of complaint, including exclusion from management of the business.

The original petition included a claim based on oppression. The House of Lords, did not have to consider whether there were sufficient grounds to justify a finding of oppression because the lower court's decision on this aspect of the case was not appealed.[128] The House of Lords therefore focused on whether the circumstances justified a winding up of the corporation. The court found that even though the removal of the director was done in the proper legal fashion, the circumstances justified a winding up order based on a violation of the "just and equitable" ground.[129]

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[125] *Ibid.* at 1065. In the United States, explicit judicial support for the "reasonable expectations" test did not seem to start until roughly 1980. Academic support in the United States began a bit earlier. For example, F. Hodge O'Neal, a renowned American authority on the topic of minority shareholder oppression, expressly endorsed the use of the doctrine of "reasonable expectations" in the 1970s. See F. Hodge O'Neal, *"Squeeze-outs" of Minority Shareholders* (New York: Callaghan & Company, 1975) at 525 [commonly cited as *Oppression of Minority Shareholders*] and O'Neal, *supra*, note 66 at 885-88. See Chapter Three, *infra*, of this thesis for more information on the status of the oppression remedy in the United States.

[126] *Supra*, note 39.

[127] Campion, Brown & Crawley, *supra*, note 3 at 236-238, 246. See also Jeffrey G. MacIntosh, "Bad Faith and the Oppression Remedy: Uneasy Marriage or Amicable Divorce?" (1990) 69 Can.Bar Rev. 276 at 296, who notes that the trend towards the use of a "reasonable expectations" analysis "can, in no small measure, be traced to" the *Ebrahimi* case.

There was no finding of oppression in *Ebrahimi*, yet Lord Wilberforce's comments in relation to the words "just and equitable" had a significant impact on the application of the oppression remedy in Canada.[130] Parallels between the statutory oppression remedy and a consideration of what is "just and equitable" were readily drawn since both imported equitable considerations of fairness. Of particular relevance to the topic of this thesis were Lord Wilberforce's comments relating to shareholder expectations.[131] In this regard, Lord Wilberforce has been credited with enshrining "shareholder expectations as the guiding principle of statute-based judicial intervention."[132] Lord Wilberforce held that a consideration of what is "just and equitable" mandated the courts to look beyond the parties' legal rights to assess whether there are "rights, expectations and obligations *inter se* which are not necessarily submerged in the company structure."[133]

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[128] *Ebrahimi, supra*, note 39 at 374.

[129] *Ebrahimi, ibid.* at 381-82.

[130] The impact is noteworthy given that the words "just and equitable" were being considered in the context of whether the circumstances justified a winding up of the corporation.

[131] *Ebrahimi, supra*, note 39 at 379. While the focus in this portion of Chapter Two is on "shareholder expectations," it should be noted that Lord Wilberforce's decision can be cited to support many other related propositions such as:

a. The "demise of untrammelled majoritarianism": MacIntosh, *supra*, note 25 at 616. In *Ebrahimi*, the court held that excluding the petitioner from management was "unjust and inequitable" and thus warranted a winding up of the corporation even though the majority of the shareholders were in agreement with this decision: *Ebrahimi, supra*, note 39 at 381.
b. That equitable considerations may, in certain circumstances, supersede legal rights: *Ebrahimi, supra*, note 39 at 379.

[132] Welling, *supra*, note 28 at 519.

Lord Wilberforce was careful to emphasize that only certain types of situations warrant the involvement of these equitable considerations. He was not prepared to exhaustively define the types of situations where such considerations would arise, yet his comments suggest that, at a minimum, they be confined to companies which have characteristics commonly associated with "closely held" corporations.[134] He specifically notes:

> It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that the company is a small one, or a private company is not enough.

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[133] *Ebrahimi*, *supra*, note 39 at 379. To give further context to this quote, the broader text from which this quote was extracted is as follows:

> The foundation of it all lies in the words "just and equitable" and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force. The words are a recognition of the fact that a limited company is more than a mere judicial entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The "just and equitable" provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

[134] See *supra*, Sections I.A.3. and I.B. of this Chapter Two which review several features of "closely held" corporations that are particularly relevant for the purposes of the oppression remedy.

> There are many of these where the association is a purely commercial one, of which it can safely be said that the basis of the association is adequately and exhaustively laid down in the articles. The superposition of equitable considerations requires something more, which typically may include one, or probably more...of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving, mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding that all, or some (for there may be "sleeping" members), of the shareholders shall participate in the conduct of the business; (iii) restriction on the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.
>
> It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of words themselves.[135]

Numerous Canadian oppression cases, decided during both the first and second stages, have cited various extracts from Lord Wilberforce's judgment which relate to shareholder expectations.[136] It has only been during the second stage, however, that the "expectations" analysis has gained wide acceptance with the Canadian courts in the oppression remedy context.[137]

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[135] *Ebrahimi*, *supra*, note 39 at 379. The type of corporation described by Lord Wilberforce in this extract is sometimes referred to as a "quasi-partnership" corporation.

[136] For example, see: *Diligenti*, *supra*, note 93; *Mason* v. *Intercity Properties Ltd.*, *supra*, note 75; *Keho*, *supra*, note 40; *Eiserman* v. *Ara Farms Ltd.*, *supra*, note 93; *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92; *Safarik* v. *Ocean Fisheries Ltd.* (1995), 22 B.L.R. (2d) 1, 12 B.C.L.R. (3d) 342 (C.A.), supplementary reasons at (1996), 25 B.L.R. (2d) 44, 17 B.C.L.R. (3d) 354; *Naneff* v. *Con-crete Holdings Ltd.* (1995), 23 B.L.R. (2d) 286, 23 O.R. (3d) 481 (C.A.) [hereinafter *Naneff*]; *Ballard*, *supra*, note 76; *Alldrew Holdings Ltd.* v. *Nibro Holdings Ltd.* (1996), 25 B.L.R. (2d) 302 (Ont.C.A.); *Watergroup Companies Inc.* v. *Stevens* [1996] 5 W.W.R. 261, 140 Sask. R. 245 (Q.B.); *Clarfield* v. *Manley* (1993), 14 B.L.R. (2d) 295; *Miller* v. *McNally* (1991), 3 B.L.R. (2d) 102 (Ont.Gen.Div.).

[137] The English courts have also adopted an "expectations" approach with respect to the application of their statutory oppression remedy: Paul L. Davies, *Gower's Principles of*

3. Case Law Analysis of Oppression Cases Decided During the Second Stage

a. Status of the "Reasonable Expectations" Test

The principles encapsulated in what has been termed herein as the "general fairness" test have not been overturned by the "reasonable expectations" test. Instead, the "reasonable expectations" test is intended to direct, with greater particularity, the application of the remedy to the conduct that violates the fundamental value which the remedy is intended to protect. This fundamental value is fairness.[138] Therefore many of the oppression cases decided during the second stage continue to support the three principles represented by the "general fairness" test.[139] The second stage cases further note, however, that one should have regard to a complainant's "reasonable expectations" when ascertaining whether oppression has occurred.[140]

A common feature of the leading oppression cases decided during the second stage is, consequently, their emphasis on the relevance of a complainant's "reasonable

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Modern Company Law, 6th ed. (London: Sweet and Maxwell, 1997) at 742; Campion, Brown & Crawley, *supra*, note 3 at 249, 253; Cheffins, *supra*, note 9 at 463-64. The English courts use the phrase "legitimate expectations" rather than "reasonable expectations." This is not the only difference between the Canadian and English "expectations" approaches. Other differences stem from the fact that the Canadian statutory oppression remedy is more broadly worded than the English statutory remedy. A detailed examination of the specific differences between the English and Canadian approaches is beyond the scope of this thesis.

[138] Campion, Brown & Crawley, *supra*, note 3 at 249, 253.

[139] For example, see *LeBlanc* v. *Corporation Eighty-Six Ltd.* [1997] N.B.J. No. 375 (C.A.). See also *supra*, Section II.B.1. of this Chapter Two for a discussion of these three principles.

[140] Chapman, *supra*, note 3 at 186-88; Campion, Brown & Crawley, *supra*, note 3 at 233, 241, 252-53.

expectations."[141] The second stage cases, however, have adopted different ways to express this relevance. Some of these cases expressly adopt the "reasonable expectations" test as *the* governing test to be applied when assessing whether oppression has occurred.[142] Other cases, in contrast, recognize the relevance of a

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[141] As noted by Blair J. in *Naneff*, (1993), 11 B.L.R. (2d) 218 (Ont.Gen.Div.) at 246-47, var'd (1994), 19 O.R. (3d) 691, 73 O.A.C. 334, 16 B.L.R. (2d) 169 (Div.Ct.), rev'd in part with respect to remedy (1995), 23 O.R. (3d) 481, 85 O.A.C. 29 (C.A.) [hereinafter *Naneff*]:

> A strong theme running through the authorities dealing with the oppression remedy is its emphasis on the protection of reasonable shareholders' expectations in the context of the shareholders' corporate relationship.

[142] For example, after conducting a fairly extensive review of the subject, J. Farley in *Ballard, supra*, note 76 at 185-86, held that:

> Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations which are to be considered are those that a shareholder has as his own individual "wish list". They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders.

In the *Ballard* case, the complainant was a shareholder. This explains why the court uses the term "shareholder" expectations.

For greater clarity in this regard, Farley J. referenced the following excerpt written by Professor Welling [*Ballard, supra*, note 76 at 186-87]:

> Thwarted shareholder expectation is what the oppression remedy is all about. Each shareholder buys his shares with certain expectations. Some of these are outlandish. But some of them, particularly in a small corporation with few shareholders, are quite reasonable expectations in the circumstances. It is not unusual for three or four individuals to go into business together with shared expectations of mutual profits, to use a corporate form as a convenient organizing vehicle, and to have a subsequent falling out. Individuals in such a situation are like the parties to a decaying marriage relationship: they cannot be expected to operate by friendly compromise in search of mutually satisfactory or "fair" settlements of the many routine disagreements that can arise. The corporate vehicle that was once a convenience now becomes a mere set of rigid rules, a frame of reference for bad tempered dispute settlement. These rules are like all legalistic rules, highly practical tools for

complainant's expectations yet relegate them to being one of several factors to consider when making a determination as to whether oppression has occurred.[143] Still others,

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> dictatorship of the majority, oppression of the minority.
>
> When this occurs, some measure of disinterested judicial activism can be useful. As the situation will usually (though not always) arise in smaller corporations one assumes that the oppression remedy was essentially designed for these corporations, where legitimate shareholder expectations are highly likely to exist, are just as unlikely to be set out on paper, yet are, because only a few parties are involved, susceptible of objective proof in the usual legal manner. This, we suggest, is the place for the oppression remedy. And there is ample authority for judicial intervention in aid of shareholder expectations in such situations. [Welling, *supra*, note 28 at 563-64].

The Ontario Court of Appeal, in the case of *Naneff*, *supra*, note 136, agreed with Farley J.'s remarks referenced above. Galligan J.A., speaking on behalf of the court in *Naneff*, further stated:

> The law is clear that when determining whether there has been oppression of a minority shareholder, the court must determine what the reasonable expectations of that person were according to the arrangements which existed between the principals: *Naneff*, *supra*, note 136 at O.R.(3d) 489.

This approach, which treats the "reasonable expectations" test as the governing test, has also been adopted by numerous other cases. For example, see *GATX Corp.* v. *Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont.Gen.Div.) [hereinafter *GATX*]; *Deluce Holdings Inc.* v. *Air Canada* (1992), 12 O.R.(3d) 131, 8 B.L.R.(2d) 294 (Gen.Div.); *Footitt* v. *Gleason* (1995) 25 B.L.R. (2d) 190 (Ont.Gen.Div.); *Themadel*, *supra*, note 76; *Dashney* v. *McKinlay* (1996), 30 B.L.R. (2d) 211 (Ont.Gen.Div.); *Murphy* v. *Phillips* (1993), 12 B.L.R. (2d) 58 (Ont.Gen.Div.), suppl. reasons B.L.R. *loc. cit.*, p. 91; *Watergroup Companies Inc.* v. *Stevens*, *supra*, note 136; *CanBev Sales & Marketing Inc.* v. *Natco Trading Corp.* (1996), 30 O.R.(3d) 778 (Gen.Div.). See also *Arthur* v. *Signum Communications Ltd.* [1993] O.J. No. 1928 (Div. Ct.), where Campbell J., on behalf of the Court, stated at paras. 6-7:

> The purpose of the s. 247 remedy is to fulfil defeated reasonable expectations. The existence of defeated reasonable expectations is a question of fact.

[143] The following comment on the oppression remedy, by Kerans J.A., in the Alberta Court of Appeal case of *Westfair Foods Ltd.* v. *Watt*, *supra*, note 3 [hereinafter *Westfair*], illustrates this distinction:

endorse both approaches.[144]

Although described differently, in essence these various judicial approaches advocate the

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> I do not for a moment suggest that that analysis about expectations deserving protection is the sole basis for rules under the statute. I think, for example, of totally unforeseen windfalls or calamities. This is not such a case, but I dare say that even in those cases the expectations of the parties are a sound starting point. And the test will always be helpful in cases where mere interests collide: *Westfair*, *supra*, note 3 at Alta.L.R.(2d) 370-71.

The court in Westfair ultimately decided that the "reasonable expectations" test was the appropriate test to apply in the circumstances.

In *Such* v. *RW-LB Holdings Ltd.* (1993), 15 Alta.L.R. (3d) 153, 147 A.R. 241, 11 B.L.R. (2d) 122 [hereinafter *Such* cited to Alta.L.R. (3d)], the court accepted that a complainant's reasonable expectations must be balanced against the "legitimate interests of the controlling faction to pursue successful policy." It emphasized that there exists an open list of factors that may be relevant when assessing the conduct in question. It then cited the following extract from the lower court decision of *Westfair* [1990] 4 W.W.R. 685 at 705, 73 Alta. L.R. (2d) 346, by Moore C.J.Q.B., which delineates some of these factors:

> the history and nature of the corporation, the type of interests affected, general commercial practice, the nature of the relationship between the complainant and alleged oppressor, the extent to which the impugned acts or conduct were foreseeable, the expectations of the complainant, the size, structure and nature of the corporation, and the detriment to the interests of the complainant: *Such*, *supra*, at 174.

See also *218125 Investments Ltd.* v. *Patel* (1995), 33 Alta L.R. (3d) 245 (Q.B.) which used the *Westfair* and *Such* cases as guidance for determining whether the conduct in question violated the oppression provisions. As well, see *400280 Alberta Ltd.* v. *Franko's Heating & Air Cond'g (1992) Ltd.* (1995), 22 B.L.R. (2d) 50 (Alta.Q.B.); *Culford* v. *Carey Elite Limousine Service Ltd.* (1991), 115 A.R. 275 (Q.B.); *Heap Noseworthy Ltd.* v. *Didham* (1996), 29 B.L.R. (2d) 211 (Ont.Gen.Div.); *Gignac, Sutts & Woodall Construction Co.* v. *Harris* [1997] O.J. No. 3084 (Ont.C.J.); *Sidaplex-Plastic Suppliers, Inc.* v. *Elta Group Inc.* (1995), 25 B.L.R. (2d) 179 (Ont.Gen.Div.); *Sexsmith* v. *Intek Inc.* [1993] O.J. No. 711 (Ont.Gen.Div.).

[144] *SCI Systems, Inc.* v. *Gornitzki Thompson & Little Co.* (1997), 147 D.L.R. (4th) 300 (Ont.Gen.Div.); *Wright* v. *Rider Resources Inc.* (1994), 21 Alta.L.R. (2d) 149, 15 B.L.R. (2d) 308 (Q.B.).

same substantive test. Each approach requires one to consider the entire circumstances of the case. In the first approach, factors such as the history and nature of the corporation, the type of interests affected, general commercial practice, the relationship amongst the participants and the size of the corporation, are relevant to the determination as to whether a particular expectation is reasonable. The second approach supports a similar analysis. It requires a court to consider a complainant's expectations in addition to an open list of other situational factors.[145] Therefore, in both approaches, the courts are considering the entire circumstances of the case to assess whether a complainant's claims are reasonable and thereby justify application of the remedy.

Although the two approaches are substantively similar, the first approach is preferable.[146] It is better to treat the "reasonable expectations" test as the governing test since, in essence, it is the circumstances of the case that determine the reasonableness of an expectation. Simply delineating a complainant's expectations as being one of several factors to consider unnecessarily confuses the issue as to how the expectation's "reasonableness" is to be ascertained. This lends further confusion to the remedy's application.

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[145] This list of factors includes those factors that are also referred to in the first expectations approach.

[146] See Campion *et al* [Campion, Brown &. Crawley, *supra*, note 3 at 252] who agree that:

> ...the reasonable expectations analysis has a sufficient scope to rationalize the application of the oppression remedy, even in those cases in which it does not add any substantive principles of fairness.

This approach is consistent with how the English courts apply their "legitimate expectations" test as interpreted by Paul L. Davies. He opines that there are classes or categories of legitimate expectations. Unfortunately, most of these categories remain vague and ill-defined. See Davies, *supra*, note 137 at 742-747 for more information on this subject. As previously noted, a comprehensive review of the application of the English oppression remedy is beyond the scope of this thesis.

The approach that advocates "reasonable expectations" as the governing test is a more coherent and logical approach to the application of the remedy. It directs attention to a clear overriding goal which is to determine the "reasonable expectations" of a complainant. One must have regard to numerous situational factors to assist in making this determination. This approach is more likely to facilitate judicial discussion on how the various circumstances in a case are relevant to a "reasonable expectations" assessment. To date, this is something that the courts have remained reluctant to discuss. This approach is also more consistent with the actual application of the oppression remedy during the second stage. The cases have consistently applied the "reasonable expectations" test as the dominant test regardless of which of the above approaches the court expressly endorsed.[147] Therefore, although variously expressed, the courts' governing concern in the oppression case law decided during the second stage was the ascertainment of a complainant's "reasonable expectations."

b. Central Focus of the "Reasonable Expectations" Test

While there is a definite consensus amongst the cases regarding the relevance of a complainant's "reasonable expectations," the cases rarely articulate what exactly is contemplated by the "reasonable expectations" test.[148] One can glean, from an analysis of the case law, that the main intention is to discern the compact or underlying agreement amongst the parties.[149] It is very unlikely that the parties' entire relationship, including all relevant expectations, will have been clearly and accurately set forth in writing.[150] The court is accordingly faced with the task of determining the underlying agreement.

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[147] For example, in the *Sidaplex-Plastic Suppliers, Inc.* v. *Elta Group Inc.* case, *supra*, note 143, a creditor brought an application based on the early lapse of a letter of credit. The letter of credit was granted to the creditor to secure its judgment against the defendant. The court discussed the importance of considering the foreseeability of the conduct, the complainant's ability to protect itself and the complainant's reasonable expectations. When applying the remedy, however, the court seemed to focus solely on the complainant's reasonable expectations. The creditor could have easily protected itself given that the creditor's lawyer had been given a copy of the incorrect letter of credit at the outset. Through the inadvertence of the creditor's lawyer, the error was not noticed. Yet, the court still held that the incorrect letter of credit was contrary to the reasonable expectations of the creditor and thereby justified a finding of oppression. Thus, an expectations analysis governed.

[148] The courts fail to discuss "the values being served by the protection of reasonable expectation": Chapman, *supra*, note 3 at 201. See also Gordon Phillips, *Personal*

There is little guidance in the case law as to how the courts should determine the parties underlying agreement, except to direct the inquiry to the entire circumstances of the case.[151] The second stage cases mainly echo the sentiment often stated in the early oppression cases that the inquiry turns very much on the specific facts of each case. The most explicit and accurate insight given by the courts comes from the *Ballard* case,[152] which has been subsequently accepted by several recent Court of Appeal cases.[153]

Remedies for Corporate Injuries (Toronto: Carswell, 1992) at 479.

[149] Campion, Brown & Crawley, *supra*, note 3 at 248-49; John P. Lowry, "The Oppression Remedy - A Canadian Approach" [1991] J.B.L. 196 at 201; *Ballard*, *supra*, note 76 at 185-86, which is subsequently cited in *Themadel*, *supra*, note 76 at para. 13; *Naneff*, *supra*, note 136 at O.R.(3d) 490, *Reynolds* v. *Nicholson* [1996] O.J. No. 2108 at para. 6.

Most cases, however, do not expressly refer to this goal. Instead, they simply emphasize the parties reasonable expectations and direct the inquiry towards the circumstances of the case. For example, see *Such*, *supra*, note 143 at para. 70-73.

[150] See *infra*, Chapter Four, Sections III.B. and III.C.3. which discuss why it will be unlikely for a court to find that the parties' entire relationship, in terms of their respective rights, interests and obligations, are completely set out in one or more written agreements.

[151] *Themadel*, *supra*, note 76 at para 13; *Reynolds* v. *Nicholson*, *supra*, note 149 at para. 6.

[152] *Ibid.*

[153] *Themadel*, *ibid.*; *Naneff*, *supra*, note 136. *Naneff* further notes that:

> The law is clear that when determining whether there has been oppression of a minority shareholder, the court must determine what the reasonable expectations of that person are according to the arrangements which existed between the principals: *Naneff*, *supra*, note 136 at O.R.(3d) 489.

Specifically, the court held that the type of expectations worthy of protection are "expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders."[154] This comment from the *Ballard* case suggests that the content of the underlying agreement may not be limited to terms the parties have agreed to. In some cases, expectations that "ought to have been" part of the agreement are worthy of protection.

Therefore the expectations inquiry is contractually driven in the sense that the main goal is to determine the parties' agreement. As well, written documentation will be given heavy weight to the extent that it reflects the parties' true agreement and is not exploitive. The court, however, is not confined solely to the rules of contract law when ascertaining the parties' underlying compact. The inquiry is much broader as it requires a consideration of the entire circumstances of the case, relevant corporate norms and whether the conduct involves the exploitation of a more vulnerable shareholder.

In summary, notwithstanding the minimal judicial comment, it is clear that the focus of the "reasonable expectations" test is the underlying agreement or compact between the parties. To assess the content of this agreement, the court will not be confined to a contractual inquiry. Written agreements are, however, a relevant consideration to the extent that they reflect the parties true agreement and are not exploitive.

Information regarding the focus of the "reasonable expectations" test helps demystify the test. More information is necessary to ensure the proper application of the test. To assist in this regard, there are five criteria which figure prominently in the application of the "reasonable expectations" test. They consequently help the courts determine the actual content of the agreement. The next section of this Chapter Two discusses each of these criteria.

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[154] *Ballard, supra*, note 76 at 186.

c. Criteria Relevant to an Assessment of Reasonable Expectations

A prevalent theme culled from the mass of oppression remedy cases is that what may be oppressive in one circumstance, may not be oppressive in slightly different circumstances.[155] One must therefore look beyond simply the type of conduct involved. As well, the wording of the oppression remedy, the "reasonable expectations" test and the case law support that one must focus on the *effect* of the conduct on the complainant when assessing whether oppression has occurred.[156] Thus the type of conduct is often of limited relevance when determining whether oppression, in the broad sense, has occurred.

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[155] *Hurley* v. *Slate Ventures Inc.* (1996), 28 B.L.R. (2d) 35 (Nfld.T.D.); *Watergroup Companies Inc.* v. *Stevens*, *supra*, note 136; *Sidaplex-Plastic Suppliers Inc.* v. *Elta Group Inc.*, *supra*, note 143; *Such*, *supra*, note 143; *347883 Alberta Ltd.* v. *Producers Pipeline Ltd.*, *supra*, note 76. Many of the cases credit the *Ferguson* case, *supra*, note 75, as the leading authority for this proposition. As noted in *Westfair*, *supra*, note 3 at Alta.L.R.(2d) 371, "the test then is always fact specific, and cases decided on other facts offer only a limited guide." See also *Neri* v. *Finch Hardware (1976) Ltd.* wherein the court comments that "each case must of course be decided on its own facts": (1995), 20 B.L.R. (2d) 216 (Ont.Gen.Div.) at para. 26 [hereinafter *Neri*], and *Pente Investment Management Ltd.* v. *Schneider Corp.*, *supra*, note 2.

[156] Campion, Brown & Crawley, *supra*, note 3 at 251-252. See also *Westfair*, *ibid.* at B.L.R.(2d) 165; *Such*, *ibid.* at 172; *Wright* v. *Rider Resources Inc.*, *supra*, note 144 at Alta.L.R.(2d) 157; *Brant Investments Ltd.* v. *KeepRite Inc.* (1991), 80 D.L.R. (4th) 161 at 176, 3 O.R. (3d) 289, 1 B.L.R. (2d) 225 (C.A.), *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92 at 60 Alta.L.R. (2d) at 144-45. See also *LeBlanc* v. *Corporation Eighty-Six Ltd.*, *supra*, note 139 at para. 24, where the court notes that "...conduct may be oppressive while legal. It is sufficient that the effects of the acts of the Corporation be unfairly prejudicial."

The nature and quality of the conduct may, however, be relevant for the "oppression" ground of the remedy: Campion, Brown & Crawley, *supra*, note 3 at 252. Similarly, the *bona fides* or intent prompting the conduct may be an additional requisite consideration when determining whether the "oppression" ground of the remedy has been violated. See *Brant Investments Ltd.* v. *KeepRite Inc.*, *supra*, at 80 D.L.R. (4th) 176; *Such*, *ibid.* at 172; Thompson, *supra*, note 3 at 219-20. Although Thompson is speaking about the application of the "reasonable expectations" test in the United States, his comments are equally applicable to the Canadian situation.

Too great an emphasis on the impugned conduct will result in a misguided appreciation of the application of the remedy.[157] The surrounding circumstances must also be assessed against the backdrop of certain well-established corporate principles.[158] The following analysis sets out five important criteria to consider when one is faced with making a "reasonable expectations" assessment. These criteria help ascertain the parties' compact. Only one of these criteria focuses on the type of conduct, as it considers whether the conduct amounts to a misappropriation of corporate assets or opportunities.

The five most relevant "reasonable expectations" criteria, gleaned from a case law analysis of the application of the oppression remedy, are as follows:

(a) written documentation that bears on the issue regardless of whether it is of contractual force;

(b) the business judgment rule and the principles it represents;

(c) the type of conduct insofar as it amounts to an appropriation of corporate assets or opportunities to the detriment of the complainant;

(d) the type of corporation since it is most likely for oppression to occur in closely held corporations or public corporations that have a dominant shareholder and illiquid shares; and

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[157] For example, granting dividends or bonuses to the exclusion of the complainant may be oppressive in one circumstance, yet not in another.

[158] The courts are thereby prevented from adopting the traditional and simple precedent based approach to the remedy's application. See MacIntosh, Holmes & Thompson, *supra*, note 4 at 132 who note that "...the oppression remedy has furnished the courts with a legislative mandate to do an end run around the old paradigm." The courts must rely on and develop their analytical abilities to ensure the remedy's application accords with its objective of fairness. This should serve to enhance judicial competence in the area of corporate law. See also Cheffins, *supra*, note 25 at 790 where he notes the lack of judicial expertise in the area of corporate law as well as Cheffins, *supra*, note 9 at 309-11, where he recognizes this lack of judicial expertise in all of Canada, England and U.S. (with the exception of the state of Delaware, U.S.). Cheffins considers England to be the best able to remedy this situation since the division of labor within the English courts is likely to quickly educate the judges responsible for corporate matters.

(e) the foreseeability of the conduct in question.

Focusing on these "reasonable expectations" criteria will allow for a more accurate identification of the situations that warrant the application of the oppression remedy.

The focus of attention will now shift to the five criteria which help drive the application of the "reasonable expectations" test. It is important to note that although the factors are analysed in isolation below, rarely will one factor be absolutely determinative. The "reasonable expectations" test requires a weighing of various factors that may not all support the same outcome.

i. Written Documentation

In the course of a "reasonable expectations" inquiry, the courts have given written documentation serious consideration to the extent that a court perceives it to be an accurate reflection of the parties' agreement.[159]

Written documentation in the form of shareholder agreements are particularly important. Shareholder agreements that deal with the matter in issue must be considered because they assist in the determination of a complainant's reasonable expectations.[160] The courts

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[159] Chapman, *supra*, note 3 at 190, 205-10.

[160] *Lyall v. 147250 Canada Ltd.* (1993), 106 D.L.R. (4th) 304, 12 B.L.R. (2d) 161 (B.C.C.A.) at 176 [hereinafter *Lyall*]. In the *Lyall* case, a violation of the complainant's rights under a unanimous shareholder agreement was considered to be a breach of the complainant's reasonable expectations. The unanimous shareholder agreement, in this case, required unanimous consent from all of the shareholders to any transaction that was outside the ordinary course of business of the corporation. The corporation was set up to effect a sale of shares. Two of the three shareholders and directors caused the corporation to not proceed with the sale of shares. The complainant, who was the third director and shareholder, objected.

The court held that failing to proceed with the sale was outside the ordinary course of business of the corporation in light of the corporation's original purpose. It was consequently contrary to the unanimous shareholder agreement which required view it as reasonable to expect that parties will abide by the provisions to which they had previously agreed.[161] If the complainant's rights as per the agreement, broadly construed, have been breached, it will often, although not always, be deemed contrary to the reasonable expectations of the complainant and thereby oppressive.[162]

The courts will generally consider the agreement as a whole as well as the surrounding circumstances to assess the purpose, extent and validity of the various rights in the

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unanimous agreement in such cases. The court accordingly held the conduct to be unfairly prejudicial to the complainant.

[161] *Lyall, ibid.* at B.L.R. (2d) 176; *GATX, supra*, note 142 at 293.

[162] *Deluce Holdings Inc.* v. *Air Canada, supra*, note 142; *Lyall, ibid.* But see the *Aquino* v. *First Choice Capital Fund Ltd.* case, *supra*, note 76, where a breach of the agreement did not constitute oppression. A contractual breach is more likely to be considered oppressive where the defendant's power within the corporation enables it to get away with the breach: *Gottlieb* v. *Adam* (1994), 21 O.R. (3d) 248, 16 B.L.R. (2d) 271 (Gen.Div.) at para. 40.

Often in these cases a complainant could also make a claim for breach of contract. For example, see *GATX, ibid.* at 291, where the court states that:

> The same facts and circumstances which support a finding of breach of contract and breach of good faith...also support a finding of "oppression," as that term is broadly used in section 241 of the *CBCA*.

The *Murphy* v. *Phillips, supra*, note 142 is another example. In this case, one of the shareholders failed to comply with the terms of a share purchase agreement which obligated such shareholder to purchase the shares of another shareholder. Such conduct was held to violate all three grounds of oppression: *Murphy* v. *Phillips, supra*, note 142 at 87. But see *Hurley* v. *Slate Ventures Inc., supra*, note 155 at para. 84, which held that "...a breach of contract is not the sort of conduct which can ground relief under the oppression remedy."

The *Watergroup Companies Inc.* v. *Stevens* case, *supra*, note 136 at W.W.R. 271-72, shows how written agreements can sometimes help preclude a finding of oppression. In this case, the court held that the granting of an interest free loan to a shareholder of a majority shareholder was not oppressive. It was set forth in the share purchase agreement which governed the purchase of the complainant's shares.

agreement.[163] Therefore the specific wording in the agreement dealing with the matter in issue may not always govern.[164] The courts have shown a willingness to protect expectations that are consistent with the motive prompting an agreement, regardless of the specific terms of the agreement. Therefore conduct that violates the spirit of an agreement may be rendered oppressive even though the conduct accords with, or is not prohibited by, the exact terms of the agreement.[165]

For example, in *218125 Investments Ltd.* v. *Patel*,[166] funds received by the corporation from a successful litigation were distributed to a select group of shareholders, which did not include the complainant shareholder. The shareholders of the corporation had previously entered into an agreement which required the corporation to consent to all distributions of monies from the corporation. Although the clause in the agreement stated that only the consent of the corporation was required, the court interpreted the clause to mean the consent of the shareholders. This interpretation was based on evidence that confirmed the intention of the agreement was to ensure corporate profits were not dissipated through payments to the directors. This was of particular concern to the complainant since he was not a director. The court held that such conduct was oppressive, unfairly prejudicial and in unfair disregard of the plaintiff.[167]

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[163] *Lyall*, *ibid.*; *Deluce Holdings Inc.* v. *Air Canada*, *supra*, note 142.

[164] *Neri*, *supra*, note 155; *Ferrier* v. *Murrell* [1994] O.J. No. 1152 (Gen.Div.). For example, see *Trnkoczy* v. *Shooting Chrony Inc.* (1991), 1 B.L.R. (2d) 202 (Ont.Gen.Div.). In this case, a shareholders' agreement provided that a certain person be manager of the corporation. The court felt that this term was not to apply where the person was incompetent and negligent. It therefore imported certain qualifications into the written agreement.

[165] Chapman, *supra*, note 3 starting at 189.

[166] *Supra*, note 143.

[167] *218125 Investments* Ltd. v. *Patel*, *ibid.* at 266. A similar situation can be found in the case of *Aquino* v. *First Choice Capital Fund Ltd.*, *supra*, note 76, to the extent that an agreement which obligated disclosure to the "corporation" was interpreted as requiring

It is not necessary for the written documentation to be in the form of a shareholder agreement in order for it to be considered relevant. In fact, it does not have to be legally binding in the traditional contract law sense in order for it to support the reasonableness of an expectation.[168] The *Themadel* case[169] illustrates this principle.[170] In this case, an issuer bid failed to conform with previous information circulars and public announcements. The court felt that the inconsistency was significant enough to warrant intervention on the basis of oppression, particularly when the issuer bid was comprehensively discussed and was made after seeking legal advice.

Written documentation is not absolutely determinative and, in some cases, may be invalid.[171] For example, the written agreement may not reflect the parties' true agreement due to the transaction costs.[172] The courts will have regard to the circumstances as a

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disclosure to the Class "B" shareholders. In this case, the defendants failed to comply with the terms of a management agreement which required disclosure to the corporation prior to recommending or proceeding with certain types of financial investments. The Class "B" shareholders were successful in claiming that this and certain other actions were unfairly prejudicial to, and in unfair disregard of, the complainant's interests.

[168] Chapman, *supra*, note 3 at 187-88. For example, see *Rivers* v. *Denton* (1992), 5 B.L.R. (2d) 212 (Ont.Gen.Div.) at 215 where the corporation's business plan was found to support an expectation of management involvement.

[169] *Supra*, note 76.

[170] See also the *Pente Investment Management Ltd.* v. *Schneider Corp.* case, *supra*, note 2, which notes, at para. 55, that shareholders must take "public announcements and documents into account when forming their reasonable expectations."

[171] In *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.*, *supra*, note 76 at QL 108, the Court of Appeal, in *obiter*, commented that the applicability of the oppression remedy may result in the "cessation of operation of an agreement or even the setting aside of that agreement."

[172] See *infra*, Chapter Four, Sections III.B. and III.C.3. for a further discussion on this topic.

whole to assess the ambit of the rights in the agreement. Thus if the courts feel the agreement is not delineated in sufficient detail, they will be inclined to supplement its terms.[173] In other cases, the agreement may represent what the parties agreed to, however the courts may override such terms if they amount to an exploitation of a more vulnerable party.[174] Often these latter types of cases will involve an element of fraud.[175]

In summary, to the extent that support for an expectation can be discerned from written materials, a court will be more inclined to find that the expectation is reasonable. Written documentation can therefore greatly assist in establishing both the existence and legitimacy of an expectation.[176] Written documentation is not, however, absolutely determinative. In some cases, it may not be an accurate reflection of the parties' agreement.[177] In other cases, the written agreement may be too opportunistic of a parties' rights.[178] Written agreements represent merely one of many potentially relevant factors.[179] Similarly, the absence of written confirmation will not be fatal to establishing the existence of an expectation.[180] For numerous reasons, the complainant often will not have written documentation that adequately establishes the basis for a particular expectation.[181]

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[173] For example, in *Trnkoczy* v. *Shooting Chrony Inc.*, *supra*, note 164, the shareholders entered into a shareholders' agreement which provided that a particular person be the manager of the corporation. The court held that this clause should not govern where such person's conduct has been negligent or incompetent.

[174] See *infra*, Chapter Four, Sections III.B. and III.C.3 for a discussion of how the strategic exercise of powers to the detriment of a more vulnerable party may be construed as creating a gap in the contract.

[175] See *Colbourne Capital Corp.* v. *542775 Alberta Ltd.* (1995), 22 B.L.R.(2d) 226 (Alta.Q.B.).

[176] Chapman, *supra*, note 3 at 205-210.

[177] This may be due to transaction costs, lack of foresight and/or communication problems. See *infra*, Chapter Four, Sections III.B. and III.C.3. for a further discussion.

[178] See *infra*, Chapter Four, Sections III.B. and III.C. which reviews how strategic actions by one party may result in the exploition of a more vulnerable party.

[179] Chapman, *supra*, note 3 at 209-210.

ii. The Business Judgment Rule

For many years, the "business judgment rule" has enjoyed a strong reverie from the common law courts in the area of corporate law. It can be said to represent the principles of internal autonomy and majority rule.[182] The oppression remedy was not intended to abolish the business judgment rule or the principles it represents, but rather to mitigate their dominance.[183] In some situations, these well-established corporate principles could effect an injustice on certain persons. The oppression remedy serves as a useful mechanism through which their influence can be tempered to the extent necessary to rectify the injustice.[184]

The courts have recognized and expressly acknowledged the need to balance, as opposed to abrogate, these principles and the potentially competing interests the oppression remedy is meant to protect.[185] In essence:

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[180] *Westfair, supra*, note 3 at Alta.L.R.(2d) 370.

[181] See *infra*, Chapter Four, Sections III.B. and III.C.3.

[182] See *supra*, Chapter One, Section II.A.

[183] One of the goals motivating the corporate statutory reforms was to recognize and encourage a balance of the often competing interests of the various corporate participants. See *infra*, note 185 and accompanying text.

[184] It is not appropriate for either the directors or the majority shareholders to, in the course of the running of the business, victimize the minority to their advantage. At the same time, as noted in the *Benson* v. *Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493, 13 B.L.R. (2d) 265 (Gen.Div.), it is not appropriate for the corporation to be run in the best interests of the minority.

[185] In the *Such* case, *supra*, note 143 at 173, the court held that one must balance:

> the legitimate interests of the controlling faction to pursue successful policy and the legitimate interests of those protected by s. 234, having

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> regard to their reasonable or legitimate corporate expectations.

In the *Ballard* case, *supra*, note 76 at 197, Farley J. held that:

> The court should not interfere with the affairs of a corporation lightly...The job for the court is to even up the balance, not tip it in favour of the hurt party.

Farley J. referred to this comment in the subsequent case of *Blair* v. *Consolidated Enfield Corp.* [1994] O.J. No. 1924 (Ont.Gen.Div.) when making a determination as to whether oppression had occurred. See also *Chiaramonte* v. *World Wide Importing Ltd.* (1996), 28 O.R. (3d) 641 at 655 (Gen.Div.). In the *Aquino* v. *First Choice Capital Fund Ltd.* case, *supra*, note 76, the court, at [1995] W.W.R. 619, quoted the following extract from the text *Shareholder Remedies in Canada*:

> ...the legislative intent of the oppression remedy is to balance the interests of those claiming rights from the corporation against the ability of management to conduct business in an efficient manner: Dennis Peterson, *Shareholder Remedies in Canada* (Toronto: Butterworths, 1989, updated to 1998) at 18.1.

In the *Benson* v. *Third Canadian General Investment Trust Ltd.* case, *ibid.* the court accepted, at O.R. (3d) 284, the following comment, made by the Ontario Court of Appeal, in *Mason* v. *Intercity Properties Ltd.*, *supra*, note 75 at O.R. (2d) 648:

> Section 247 [the oppression provision] cannot be permitted to be used as a weapon in the hands of minority shareholders to extort decisions from the majority under threat of litigation. On the other hand, it would be wrong to penalize a minority shareholder forced to take strenuous measures to protest exclusion from company affairs. This would render nugatory the rights of a minority shareholder to relief from the unfair conduct of the majority which is stigmatized under s. 247.

In the *Keating* v. *Bragg* case [1997] N.S.J. No. 248 (C.A.), the court highlighted, at para. 31, the recognition made by the trial judge that the purpose of the oppression remedy is to "provide a method of balancing the manner in which the majority may operate a company with the interests of a minority shareholder": [1996] N.S.J. No. 554 (S.C.) at para. 118.

Several of the first stage cases also recognized the need to balance the various competing corporate interests when considering the application of the oppression remedy. For example, see *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92 at Alta.L.R. (2d) 132. See also at Alta.L.R. (2d) 145, wherein the court adopts the following statement by Professor Shapira:

> The basic formula for establishing unfair prejudice, it is submitted, should be this. The court should seek to balance protection of the minority's interest against the policy of preserving freedom of action for management and the right of the members to back up their investment by their vote. The fair view of the majority should carry considerable weight, but should not be critically important...: G. Shapira, "Minority Shareholders'

> The court should seek to balance protection of the minority's interest against the policy of preserving freedom of action for management and the right of the members to back up their investment by their vote. The fair view of the majority should carry considerable weight, but should not be critically important.[186]

Therefore, while abuses against shareholders and other parties have been given statutory protection through the oppression remedy, the remedy does not invalidate the relevance of the business judgment rule and the principles it represents.

The business judgment rule must accordingly be considered when making an assessment as to whether a particular expectation is reasonable. It is a reminder that the application of the oppression remedy mandates the balancing of various, often conflicting, interests.[187] The rights of management and the controlling faction must be balanced against the rights of other participants not to be exploited. In terms of application, this essentially means that if business decisions are carefully considered, or if there are valid commercial reasons justifying the decisions, the court will be less inclined to interfere with them. The following decisions illustrate the ongoing relevance of the business judgment rule.

(1) *Brant Investments Ltd.* v. *KeepRite Inc.*:[188]

The *Brant* case involved a corporation which proposed to purchase certain manufacturing equipment from a non-arms length corporation. The purchaser corporation had

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Protection - Recent Developments" (1982) 10 N.Z.U.L.R. 134 at 145-46.

[186] Shapira, *ibid.* at 145-46.

[187] Peterson, *supra*, note 185 at 1.5 - 1.7. As noted by the Court of Appeal in *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.*, *supra*, note 76 at QL 118, the fairness mandated by the oppression remedy "requires a balancing of the interests of all of the parties who have interests." The court went on to list minority shareholders, majority shareholders, directors and the corporation.

[188] *Supra*, note 156 [hereinafter *Brant* cited to B.L.R.(2d)].

established an independent committee to analyse the viability of the proposed purchase. The committee was comprised of directors of the purchaser corporation who had no involvement with the vendor corporation. The committee also hired outside consultants to assess the ramifications of the acquisition. While over two-thirds of the shareholders of the purchaser corporation approved the purchase, approximately twenty-eight percent exercised their right of dissent, thereby entitling them to have their shares bought by the corporation for fair value. The parties could not agree on a price. Therefore the purchaser corporation brought an action to determine fair value. The dissenting shareholders responded with an oppression action, which was tried simultaneously with the fair value action. The essence of the oppression action revolved around the proposed acquisition and the propriety of the conduct of the committee.

The trial judge dismissed the oppression action and fixed the fair value of the shares. The dissenting shareholders appealed both decisions. The Ontario Court of Appeal dismissed both appeals.

In the course of disposing of the appeal, McKinlay J.A., on behalf of the Court of Appeal, accepted the finding of the trial judge that "the function of the committee was to assure that the impugned transaction be fair to the minority shareholders as well as in the best interests of" the purchaser corporation.[189] McKinlay J.A. acknowledged that business decisions, even though honestly made, could still be subject to court scrutiny under the oppression remedy.[190] He also noted that "a business decision, which, if made honestly in the best interests of the corporation, should not be interfered with."[191] The extent to which directors should inquire into possible alternatives was considered to be one such business decision.[192]

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[189] *Brant, ibid.* at 256.

[190] *Brant, ibid.* at 263.

[191] *Brant, ibid.* at 254.

McKinlay J.A. held that a trial judge should not supplant his or her business judgment for that of the internal management of the corporation.[193] Consequently it is important to ascertain what business decisions are matters of business judgment with which the court should not interfere. Clearly, the existence of an independent committee and the involvement of outside consultants significantly reduced any inclination of the court to question the resulting business decisions.

(2) *Ludlow* v. *McMillan*:[194]

In the *Ludlow* case, the court was required to consider, among other things, whether the payment of an excessive management fee violated the oppression remedy. In holding that it did, the court noted that there was no valid commercial reason for the payment.[195] Although the court does not expressly reference "the business judgment rule," regard for the commercial motivations represents another way of expressing the relevance of the rule when assessing whether oppression exists.

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[192] *Brant*, *ibid.* at 254.

[193] *Brant*, *ibid.* at 263. McKinlay J.A. explained further that this is regardless of the amount of evidence before the trial judge because:

> He is dealing with the matter at a different time and place; it is unlikely that he will have the background knowledge and expertise of the individuals involved; he could have little or no knowledge of the background and skills of the persons who would be carrying out any proposed plan; and it is unlikely that he would have any knowledge of the specialized market in which the corporation operated. In short, he does not know enough to make the business decision required: *Brant*, *ibid.* at 263.

[194] [1995] 6 W.W.R. 761, 19 B.L.R.(2d) 102 (B.C.S.C.) [hereinafter *Ludlow* cited to B.L.R.(2d)].

[195] *Ludlow*, *ibid.* at 106. In the *Ludlow* case, the management fee amounted to more than seventy percent of the corporation's cash assets, which was the largest asset of the corporation.

(3) *Miller* v. *McNally*:[196]

The *Miller* case supports the proposition that a "valid business purpose" is a relevant consideration when determining whether certain conduct violates the statutory oppression remedy. The facts of the case involved a corporation that had three shareholders, one of whom was the applicant. This corporation agreed to lease certain real property for less than fair market value to a corporation which was wholly owned by one of the shareholders (and directors) of the lessor corporation. The court noted that the effect of this transaction would be to benefit one shareholder to the exclusion of the others. The transaction was held to be oppressive since, from the perspective of the lessor corporation, there was no valid business purpose which would justify the conduct in question.

The case law examples reviewed above confirm the relevance of the business judgment rule and the principles it represents. Although support for the rule is expressed in different ways, it is clearly a relevant consideration when applying the "reasonable expectations" test.[197]

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[196] *Supra*, note 136 [hereinafter *Miller*].

[197] Additional examples are as follows:"it would be an abuse of minority power" to allow the minority shareholders to run the corporation in their best interests: *Benson* v. *Third Canadian General Investment Trust Ltd.*, *supra*, note 184 at B.L.R.(2d) 285; "Courts should not usurp the function of the board of directors in managing a corporation. Nor should it supplant the legitimate exercise of control by the majority: *Watergroup Companies Inc.* v. *Stevens*, *supra*, note 136 at W.W.R. 263. The *Watergroup Companies Inc.* case also adopted the following quote from *Brant Investments Ltd.* v. *Keeprite Inc.* (1987), 37 B.L.R. 65, 60 O.R.(2d) 737 (H.C.J.), supplementary reasons at 61 O.R.(2d) 469, aff'd (1991), 1 B.L.R.(2d) 225, 3 O.R.(3d) 289 (C.A.): "Business decisions, honestly made, even if unwise, should not be subjected to microscopic examination by the court." In *Alldrew Holdings Ltd.* v. *Nibro Holdings Ltd.*, *supra*, note 136, the court considered it relevant to determine whether there were valid business reasons for the impugned conduct. Similarly, in *Ballard*, *supra*, note 76 at 211, the court queried: "Was there any business purpose to the complained-of transactions?" See also *CW Shareholdings Inc.* v. *WIC Western International Communications Inc.* [1998] O.J. No. 1886 at 24-26 (Gen.Div.); *Rogers Communications Inc.* v. *McLean Hunter Ltd.* (1994) 2 C.C.L.S. 223

iii. Appropriation of Corporate Opportunities and Corporate Assets

The courts have shown little tolerance for conduct that amounts to an appropriation of a corporate asset or opportunity, to the detriment of the complainant. It is considered reasonable for a shareholder to expect that there will not be a wrongful diversion of corporate property, at the shareholder's expense. Appropriation of corporate opportunities or assets constitutes a very broad category. Many different types of specific actions fall within its confines. The judiciary's intolerance is revealed in decisions that find oppression even though the complainant was invited to participate in, or had previously consented to, the impugned transaction.

Technically, the "type of conduct," in terms of whether it involves an appropriation of corporate property, is a main component of this rule. It therefore stands as an exception to the general rule that one should be leery about focusing on the type of conduct in oppression cases. The type of conduct is not the sole focus, however, as detriment to the complainant is an integral part of this factor. The effect of the conduct is consequently still relevant.

In a general sense, corporate opportunities are technically corporate assets. The appropriation cases, though, usually retain the distinction such that the latter generally involve tangible assets. To maintain this consistency with the case law, the appropriation of corporate opportunity cases are reviewed herein separately from those involving the appropriation of corporate assets. This separation is merely in form, not in substance. For the purposes of the oppression remedy, the above principles apply equally to both

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at 245 (Ont.Gen.Div.); *Armstrong World Industries Inc.* [1997] O.J. No. 4620 (Gen.Div.).

Several cases decided during the first stage also recognized the relevance of the business judgment rule. For example, see *First Edmonton Place Ltd.* v. *315888 Alberta Ltd.*, *supra*, note 92 at Alta.L.R. (2d) 142, where the court noted that several previous cases have accepted that the oppression remedy was only intended to temper the dominance of majority rule, not abrogate it.

types of conduct.

(1) Appropriation of Corporate Opportunities

The *Chiaramonte* v. *World Wide Importing Ltd.*[198] decision involved a situation where the complainant was invited to participate in a transaction that was later held to be oppressive on the basis that it amounted to an appropriation of a corporate opportunity. In this case, the complainant was a minority shareholder and director of a corporation. He was invited by the president of the corporation to become a shareholder of a new corporation provided he also contribute financially in an undefined amount. The complainant was not interested and suspected a potential conflict of interest between the corporation in which he was a shareholder and the business of the new corporation. The complainant brought an oppression application on the basis of this and certain other conduct.

The court held that the aforesaid conduct was oppressive and unfairly prejudicial. It recognized that there were legitimate business reasons for setting up a new company and that the current company did not have sufficient expertise to carry on the business. The court went on to note, however, that the new business was integrally related to the "goals and objectives" of the original corporation. Therefore since the share holdings would not be identical and absent any other safeguards, the conduct amounted to an appropriation of a corporate opportunity that would result in an inevitable conflict of interest. The notice and initial invitation to the complainant to participate were not sufficient to negate a finding of oppression.

The *Neri* case[199] had a similar outcome. In this case, the corporation, which will be referred to herein as FH, sold hardware supplies to retail companies. FH had ten shareholders, half of whom were employed by FH. The complainant was one of the working shareholders, however he was not involved in management. The managing shareholders decided to purchase a corporation that manufactured paintbrush supplies. They invited the complainant to participate and stipulated that the required investment would be approximately eighty thousand dollars. Although the complainant declined, he did not expressly object to the purchase at that time. The remaining five shareholders, who were the non-working shareholders, were not only aware of the proposed purchase, but also encouraged the working shareholders to pursue it. The relationship between the complainant and the other working shareholders began to deteriorate which resulted in the complainant's employment resignation. The application for oppression was brought after the complainant was unsuccessful in his attempts to sell his shares. The complainant also brought evidence to support his argument that the new corporation had used the computer system and one of the managers of FH at no cost, and had borrowed funds of FH interest free for three months.

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[198] *Supra*, note 185 [hereinafter *Chiaramonte*].

[199] *Supra*, note 155.

The court held that notwithstanding the fact that the complainant was advised of, and did not object to, the purchase of the corporation, the purchase constituted an appropriation of a corporate opportunity by the managing shareholders from FH.[200] It would have been in the best interests of FH to purchase the corporation. The businesses were complementary in the sense that FH could purchase supplies from the corporation. The court noted that this put the managing shareholders in a position of conflict.[201] FH would want to purchase the items at as low a price as possible while the corporation would want the opposite. This conflict position was further accentuated by allowing the corporation to use the assets of FH without proper compensation.[202] The court accordingly held that the conduct was unfairly prejudicial to the complainant and unfairly disregarded his interests.[203]

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[200] *Neri, ibid.* at 225.

[201] *Neri, ibid.* at 225.

[202] *Neri, ibid.* at 225.

The case of *400280 Alberta Ltd.* v. *Franko's Heating & Air Conditioning (1992) Ltd.*[204] also involved the appropriation of a corporate opportunity, except in this case, it was done on a clandestine basis. The managing director and majority shareholder of Franko's Heating and Air Conditioning (1992) Ltd. diverted corporate contracts from this corporation to a corporation that was wholly owned by the managing director. He also used the goodwill of Franko's Heating and Air Conditioning (1992) Ltd., as well as certain of its other assets, without appropriate compensation. The court held that the conduct was oppressive, unfairly prejudicial and showed unfair disregard to the interests of the complainant.

(2) Appropriation of Corporate Assets

Not surprisingly, the cases involving the appropriation of corporate assets often consist of the use or acquisition of a corporation's asset, or the authorization of such use or acquisition, by one or more corporate participants, without such person(s) obtaining appropriate payment for same. For example, in the *Miller* case,[205] one corporation, the lessor corporation, granted a lease at far less than fair market value to another corporation, which was wholly owned by a shareholder of the lessor corporation. In another case, a corporation transferred land, at less than fair market value, to corporations owned or controlled by the majority shareholder of the transferor corporation.[206] This majority shareholder also caused the transferor corporation to pay for some of his personal, and other business, expenses. These actions, along with certain others,[207] amounted to an appropriation of corporate assets which benefited the majority shareholder at the expense of the minority shareholder. Thus, they were held to be unfairly prejudicial and in unfair disregard of the minority shareholder's interests.[208]

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[203] *Neri, ibid.* at 225.

[204] *Supra*, note 143.

[205] *Supra*, note 136.

[206] *Loveridge Holdings Ltd.* v. *King Pin Ltd.* (1991), 5 B.L.R. (2d) 195 (Ont.Gen.Div.).

The *Ballard* case[209] provides another example. In this case, the majority shareholder of a corporation, in an attempt to regain a greater percentage of the share ownership, transferred certain property to the corporation in exchange for shares in the corporation. Proper valuations were not done such that the number of shares issued in exchange for the transferred property significantly exceeded the value of the property. The court drew attention to these types of situations in which the directors cause a corporation to enter into an agreement with one of them or with a majority shareholder. If the agreement confers a benefit on the director or shareholder, then "prima facie this would appear to be oppressive and unfair to the minority shareholders."[210] The court ultimately found that the conduct, at a minimum, breached the grounds of unfair prejudice and unfair disregard.[211]

Many of these appropriation of assets cases involve wrongful dealings with corporate funds. These dealings cover a wide range of conduct including: the use of corporate funds for personal matters;[212] the granting of interest free, low interest, and/or security free loans to the benefit, either directly or indirectly, of only certain shareholders;[213] the payment of excessive management fees or bonuses;[214] the declaration of excessive dividends;[215] the refusal to pay dividends for an extended period while granting certain shareholders interest free loans;[216] effecting a change in a well-established bonus policy which resulted in the complainant no longer receiving any bonuses.[217]

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[207] Some of the other actions included excessive management bonuses and loans to the benefit of the majority shareholder.

[208] *Loveridge Holdings Ltd.* v. *King Pin Ltd.*, *supra*, note 206 at 201.

[209] *Supra*, note 76.

[210] *Ballard*, *ibid.* at 211.

[211] *Ballard*, *ibid.* at 220.

[212] *Such*, *supra*, note 143

The foregoing provides several examples of the types of conduct that may fall within this category. Although this factor is largely conduct based, it is important not to be too conduct-oriented. Two cases may involve similar conduct yet have very different results in terms of whether the actions were held to be oppressive. For example, in *Watergroup Companies Inc.* v. *Stevens,*[218] an interest free loan was granted to the shareholder of the majority shareholder. This was held not to be oppressive because it was disclosed to the complainant at the time of the purchase of shares.[219] The corporation also granted security to one shareholder to secure its shareholder loan. This had the effect of elevating the priority of this loan over unsecured loans from another shareholder. The court felt this conduct was also not oppressive since this loan was used by the corporation to pay off several loans from the other shareholder.[220]

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[213] *Neri, supra*, note 155; *Aquino* v. *First Choice Capital Fund Ltd., supra*, note 76; Loveridge *Holdings Ltd.* v. *King Pin Ltd., supra*, note 206.

[214] *Ludlow, supra*, note 194.

[215] *Ludlow, ibid.*

[216] *218125 Investments Ltd.* v. *Patel, supra*, note 143.

[217] *Naneff, supra*, note 136.

[218] *Supra*, note 136 [hereinafter *Watergroup* cited to W.W.R.].

[219] *Watergroup, ibid.* at 271-72.

[220] *Watergroup, ibid.* at 275-76.

The case of *Chiaramonte*[221] provides another example. This case involved the issuance of unequal bonus remuneration. The court found that there was no oppression. The parties had differing duties. The approval of the bonus resolutions by the complainants, who were well aware of the corporation's financial status, was considered ideal evidence of their expectations.[222]

iv. Type of Corporation and the Relevance of a Pre-existing Relationship

The oppression remedy and the "reasonable expectations" test are applicable regardless of whether the corporation is a public corporation or a closely held corporation.[223] The shareholder expectations will vary significantly depending upon the type of corporation that is involved.[224] As a general rule, there are far fewer oppression cases involving public corporations. However, not all public corporations have identical features. For the purposes of the oppression remedy, in addition to distinguishing between closely held and public corporations, it is also important to distinguish between two prototypical types of public corporations:

(a) public corporations that have liquid shares and are widely held, with no dominant shareholder;

(b) public corporations that have illiquid shares and a dominant shareholder.

Section I. of this Chapter Two provides further information on the characteristic features of each of the three types of corporations referenced *supra*. The impact of the type of corporation on the applicability of the oppression remedy is discussed in more detail in the immediately following text.

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[221] *Supra*, note 185.

[222] *Chiaramonte*, *ibid.* at 659.

[223] *Themadel Foundation* v. *Third Canadian Investment Trust Ltd.* (1995), 23 O.R.(3d) 7, 18 B.L.R.(2d) 209 (Gen.Div.) at para. 9 B.L.R.(2d), aff'd [1998] O.J. No. 647 (C.A.) [hereinafter *Themadel*].

[224] Campion, Brown & Crawley, *supra*, note 3 at 234-35.

(1) Public Corporations

There are, in fact, so few cases involving public corporations that it is difficult to draw clear guidelines to help steer the remedy's application in situations involving public corporations. Several points, however, are worthy to note when considering the application of the oppression remedy to public corporations. Some, although not all, of these points apply to public corporations with a dominant shareholder, as well as those without. The points that are reviewed first herein are those applicable to all public corporations regardless of whether or not they have a dominant shareholder.[225]

The first point is that the approach of the courts tends to be more objective in nature when making a "reasonable expectations" assessment in the context of a public corporation.[226] This objectivity is inevitable since in most public corporations, the expectations of a complainant must be assumed.[227] The greater number of participants in public corporations renders it less likely that each will have a specific agreement clarifying their expectations. As well, the oppression claims arising in respect of public corporations will often involve a group of complainants. This enhances the need for objectivity as the tendency is to consider their expectations as a group. The court will consider the particular elements the complainants' have in common and do an expectations analysis from that viewpoint. In contrast, oppression claims involving closely held corporations usually have a much smaller number of complainants. The smaller number of complainants makes a subjective inquiry much more feasible.

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[225] In many of the cases, the shares will also be fairly illiquid. Otherwise, a complainant would simply sell its shares as this would be much quicker and much less expensive. The illiquidity may be due to the shares being thinly traded on the stock market or to the shares or the corporation being delisted. As well, the illiquidity may stem from the stock market value being significantly less than the shares' true value. This type of situation may occur when the oppressive conduct has the effect of decreasing the value of the complainant's shares.

[226] For example, Campion *et al*, comment that in the *Westfair* case, *supra*, note 3, which involved a public corporation:

> the reasonableness of the expectation claimed was more a matter to be determined by reference to the expectations common to shareholders of issuer corporations at large, than an analysis of the expectations which were individual to the shareholders of that corporation: Campion, Brown & Crawley, *supra*, note 3 at 250.

[227] *Ballard*, *supra*, note 76 (obiter); *AMCU Credit Union Inc.* v. *Olympia & York Developments*, *supra*, note 76.

The objective approach is reflected both in the heavy reliance the courts give to traditional corporate norms and to the standard industry norms of conduct for the particular corporation. Each of which are discussed in turn below.

The courts are more inclined to rely on traditional corporate norms when making an assumption as to a complainant's expectations in the context of a public corporation.[228] The business judgment rule, and the principles it represents, remain a critical consideration when making a determination as to whether oppression has occurred.[229] The heavy weight accorded the business judgment rule for public corporations may be partially linked to the misperception that all public corporations are widely held, highly liquid, professionally managed and adequately monitored by the stock market. These features would render the potential for exploitation or shareholder conflict to be minimal.[230]

The courts reliance on traditional norms also means it will be unusual for a court to uphold shareholder expectations relating to management involvement in public corporations.[231] The courts' position is much more relaxed if a closely held corporation is involved.

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[228] Campion, Brown & Crawley, *supra*, note 3 at 250. These authors cite the *Westfair* case, *supra*, note 3, as support for this principle.

[229] For example, *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*, *supra*, note 197 at 24-26 (and generally).

[230] The majority of public corporations in Canada have a dominant shareholder and low liquidity: Daniels & MacIntosh, *supra*, note 5 at 877.

Another objective element which the courts take into account when applying the "reasonable expectations" test is whether the conduct accords with general industry practice. For example, in *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*,[232] the corporation was the target of a takeover battle. The corporation entered into a Pre-Acquisition Agreement with one of the bidders which contained significant inducements. Another bidder, who was also a minority shareholder, brought an oppression claim. One of the grounds was that the inducements contained within the Pre-Acquisition Agreement were unreasonable and extravagant. The court held that there was no oppression because the inducements contained within it were standard practice and within the normal industry parameters.[233]

The *Themadel* case[234] also supports the relevance of the industry standard of conduct and confirms how legislation can provide insight into the appropriate standard of conduct. In the *Themadel* case, the court noted that legislation prescribing a certain standard of conduct could be relied upon when assessing the typical behavior to expect of a corporation, even if the legislation does not provide a private claim for relief.[235]

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[231] See *supra*, Section I. of this Chapter Two.

[232] *Supra*, note 197.

[233] *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*, *supra*, note 197 at 46.

[234] *Supra*, note 76.

[235] In the *Themadel* case, *ibid.* misrepresentations in the information circular constituted an offence under the applicable securities legislation. Although such legislation did not provide an independent private claim for same, these provisions were relied upon when assessing the standard of behavior the complainant could reasonably expect from the public corporation.

The heavy weight conferred in the oppression cases to press releases and similar announcements by public corporations ties in with the relevance of industry standards. Carthy J.A. recognizes the relevance of public pronouncements in the following excerpt from *Thermadel*:

> The public pronouncements of corporations, particularly those that are publicly traded, become its commitments to shareholders within the range of reasonable expectations that are objectively aroused.[236]

The basis for this comment is that it is an offence under the relevant securities legislation for public corporations "to be other than truthful in public pronouncements."[237] Therefore as established in the *Themadel* case, while the relevant securities legislation may not provide a private claim for this type of violation, it is still considered to be indicative of the standard of conduct one should reasonably expect of a corporation. There is consequently a greater likelihood that a complainant's expectation will be considered reasonable in an oppression claim if the expectation is based on a press release by a public corporation.

Another general point to note in respect of public corporations is that a number of the public corporation oppression cases involve takeover situations.[238] These takeover oppression cases occur in public corporations with a dominant shareholder as well as those without.[239] A typical takeover situation will put directors of the target corporation in a conflict of interest position. If a takeover bid is successful, the new owners will vote in their own directors to replace the previous ones. There is consequently an incentive for incumbent directors to defend against a takeover so as to entrench their positions.[240] Such a defense, however, may be contrary to the best interests of the target corporation.[241] Therefore too active a defense may prompt a dissatisfied party to launch an oppression claim. At the same time, the director may be vulnerable if it takes too little action in the face of a takeover bid.[242] The courts are generally left to the difficult task of assessing the appropriate balance.

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[236] *Themadel*, *ibid.* at 4.

[237] *Themadel*, *supra*, note 224 at O.R.(3d) 9. See also *Pente Investment Management Ltd.* v. *Schneider Corp.*, *supra*, note 2 at para. 55.

[238] *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.*, *supra*, note 76; *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*, *supra*, note 197; *Pente Investment Management Ltd.* v. *Schneider Corp.*, *ibid.*; *Themadel*, *supra*, note 76.

[239] For example, *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*, *ibid.* involved a fight between two significant shareholders. While one had a more significant equity interest than the other, they interests were somewhat similar since both were significant shareholders. In contrast, the *Themadel* case, *ibid.* involved corporations that had one dominant shareholder who had effective control over both of them.

The oppression claim in takeover situations is therefore usually aimed at the directors of the corporation for either their actions or their inaction. If there is a dominant shareholder, a claim may also be brought against such shareholder if the complainant perceives that the shareholder influenced the directors to act as they did.[243]

The foregoing points apply equally to public corporations with a dominant shareholder as to those without. It is now important to consider how the existence of a dominant shareholder and illiquid shares in a public corporation will affect both the likelihood of oppression occurring and the likelihood of an oppression claim being brought.[244] The existence of a dominant shareholder in a public corporation will greatly enhance the potential for shareholder conflicts.[245] Dominant shareholders in public corporations will often have a significant influence over the management of the corporation and may exercise this power to the detriment of the minority shareholders. This type of situation has the potential to give rise to oppression claims involving the appropriation of corporate assets and/or opportunities by the dominant shareholder and, possibly, mismanagement.[246] Illiquid shares also enhance the chances for an oppression claim due both to the resulting vulnerability of the shareholder as well as the difficulty in exiting the corporation through a sale of the shares.

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[240] *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.*, *supra*, note 76.

[241] Outside consultation is often sought in takeover situations by the directors and management of target corporations "to minimize the inherent conflict in their position": *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.*, *supra*, note 197 at 31.

[242] *Rogers Communications Inc.* v. *MacLean Hunter Ltd.*, *supra*, note 197 at 245.

[243] A shareholder may be dominant even if it does not own a majority of the shares. The main requisite is that it owns a sufficient number of shares to carry significant influence with management. It may be enough if the shareholder simply owns a proportionately larger number of shares in comparison to the other shareholders.

[244] See *supra*, Section I.A.2 for a more extensive review of the impact of dominant shareholders and illiquid shares on the likelihood of an oppression claim.

The courts have not yet expressly emphasized the existence of a dominant shareholder or illiquid shares as important features to watch for in public corporations. The common perception is that the need for the oppression remedy is significantly reduced when a public corporation is involved, with little additional discussion on the subject. This perception wrongly assumes that all public corporations fit the stereotype that their shares are highly liquid and their share holdings are widely dispersed. In fact, most public corporations in Canada have low liquidity and a dominant shareholder.[247] These features not only increase the likelihood of oppression occurring, but also that an oppression claim will be sought since there is no quick and inexpensive market exit option.[248] It is therefore important to be sensitive to the existence of these features and accordingly, the potential vulnerability that may arise.

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[245] MacIntosh, Holmes & Thompson, *supra*, note 4 at 87.

[246] For example, *Aquino* v. *First Choice Capital Fund Ltd.*, *supra*, note 76.

[247] Daniels & MacIntosh, *supra*, note 5 at 877.

[248] For example, in the *Themadel* case, *supra*, note 76, the corporations had a dominant shareholder and their shares had low liquidity. As well, in the *347883 Alberta Ltd.* v. *Producers Pipelines Ltd.* oppression case, *supra*, note 76, the public corporation was not listed and was infrequently traded on the over-the-counter market.

Therefore the oppression remedy applies to all types of public corporations. Oppression claims, however, are less likely to arise if the public corporation has liquid shares and is widely held, with no dominant shareholder.

(2) Closely Held Corporations

Shareholders in closely held corporations are generally more vulnerable to oppression. This vulnerability stems partly from the illiquid nature of their shares, and partly from the overlap between shareholders and management. See *supra*, Section I.A.3. and I.B. of this Chapter Two for a more comprehensive discussion on the subject.

As well, it is more likely for shareholders of closely held corporations to have expectations to be involved in a management or employment capacity. The courts are therefore more inclined to uphold these types of shareholder expectations in closely held corporate oppression cases, even though they are contrary to the traditional corporate structure. See *supra*, Section I.A.3. for a further discussion on this topic. An oppression claim based on thwarted expectations in these regards is more likely to be upheld. Traditional corporate norms, while still relevant, are consequently less important.[249]

A court will be even *more* inclined to uphold expectations as to management or employment involvement if the closely held corporation is a "quasi-partnership" corporation.[250] The "quasi-partnership" corporation is a term that gained particular recognition as a result of the *Ebrahimi* case discussed *supra*.[251] In essence, it represents a business that is intended to be run as a partnership yet is formally structured as a closely held corporation. The parties often incorporate to capitalize on certain tax benefits and to take advantage of the limited liability enjoyed by corporations. In addition to making a return on their investment, the shareholders in these types of corporations typically expect to be involved in the corporation in employment and management capacities, as this would be consistent with a partnership structure.[252] Therefore to the extent one can establish that the parties intended the corporation be run analogous to a partnership, it is more likely that the court will find a shareholder's expectation relating to employment and/or management to be reasonable.[253]

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[249] Thompson, *supra*, note 10 at 702.

[250] Prentice, *supra*, note 8 at 60-61.

[251] See *supra*, notes 118, 119 and accompanying text. See also *Ebrahimi*, *supra*, note 39 at 379-80.

Shareholders in *quasi*-partnership corporations may also have misconceived notions as to the liquidity of their shareholder interest. Such shareholders often perceive that their shareholder interests are as liquid as partnership interests. In a partnership, unless there is an agreement to the contrary, a disgruntled partner can force the partnership to be wound up and dissolved in the event the partner decides to leave the partnership.[254] This ability to force a dissolution provides a partner with tremendous bargaining leverage.[255] In contrast, unless expressly contracted for, a shareholder in a closely-held corporation does not have this power.[256] An expectation relating to the right of dissolution if a shareholder no longer participates in management will be much more common in a closely held (and quasi-partnership) corporation.[257]

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[252] Prentice, *supra*, note 8 at 61.

[253] *Rivers* v. *Denton*, *supra*, note 168 at 215-216, 218-219.

[254] For example, see sections 35, 36 and 42 of the *Partnership Act*, R.S.A. 1980, c. P-2.

[255] O'Neal & Thompson, *supra*, note 17 at 9-4; Hetherington, *supra*, note 17 at 20.

[256] A corporation has an existence independent of its shareholders which is sometimes referred to as "perpetual existence": Capel, *supra*, note 8 at 1004; Thompson, *supra*, note 10 at 701. The ability of a partner to withdraw from a partnership is similar to the power of a shareholder in a public corporation that has very liquid share holdings. In the latter situation, the power comes from the shareholder's ability to sell its investment on the stock market: Hetherington, *ibid.* at 20-21.

The case of *Rivers* v. *Denton*[258] is an example of a "quasi-partnership" situation. In this case, the applicant was one of three shareholders. The applicant, who was also a director of the corporation, had been excluded from having any management involvement with the corporation. He brought an application for the winding up of the corporation on the ground of oppression.[259] The court took note of several factors before deciding that the corporation was intended to be run as a partnership, thereby entitling the applicant to participation in management. One factor was that the shareholder agreement mandated that all three shareholders be represented on the board of directors and that the quorum requirements for each of the directors' and shareholders' meetings be one hundred percent. The decisions, however, did not have to be unanimously approved. Another relevant factor was that the business plan referred to all three shareholders as partners. These features formed the basis of the quasi-partnership finding.

In some cases, it may be difficult to prove that a partnership relationship was intended notwithstanding the corporate form. Evidence of a pre-existing partnership relationship may help surmount this hurdle.[260] Clearly, however, the existence of a situation analogous to a partnership is not a prerequisite for finding liability under the oppression remedy.[261]

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[257] Campion, Brown & Crawley, *supra*, note 3 at 234. These authors only refer to closely held corporations; they do not specifically refer to "quasi-partnership" corporations.

[258] *Supra*, note 168.

[259] Therefore although decided under the winding up provision of the *OBCA*, the relevant findings were based on the ground of oppression. In all major respects, the wording of this ground is the same as the statutory oppression remedy.

[260] For example, in *Three Point Oill Ltd.* v. *Glencrest Energy Ltd.* (1997) 5 Alta.L.R. (3d) 140 (C.A.), in order to assess whether the complainant had a right to management participation, the court considered whether the business existed prior to incorporation or whether it commenced at the same time as the corporation. See also *LeBlanc* v. *Corporation Eighty-Six Ltd.* [1997] N.B.J. No. 375 (C.A.).

In summary, it is most likely for oppression claims to arise in respect of closely held corporations. There is still room for the remedy in public corporations, particularly if the public corporation has a dominant shareholder and illiquid shares.

v. Foreseeability

The foreseeability of the impugned conduct is another relevant consideration when assessing the reasonableness of an expectation.[262] The less foreseeable certain conduct is, the less likely a person would realistically expect such conduct to occur. As well, if certain potentially oppressive conduct is very foreseeable, yet no protective steps are taken by the complainant, it raises doubts as to whether an expectation that the conduct would not occur should be considered to be part of the shareholder compact.

None of the main factors enumerated in this Section II.C.3.c. are absolutely determinative of a particular outcome with respect to the oppression remedy. The foreseeability of the conduct is no exception. Therefore conduct that is completely foreseeable may still be deemed oppressive in certain circumstances. A typical situation where this may occur is one that involves the appropriation of corporate assets or opportunities to the detriment of the complainant.[263]

Foreseeability is not expressly discussed in most of the oppression cases decided during the second stage. This is possibly because it is so intrinsically tied to the reasonableness of an expectation. The judiciary's focus on whether there was prior disclosure of the conduct and the extent to which the conduct is consistent with previous practice indirectly support the relevance of this factor.

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[261] *Safarik* v. *Ocean Fisheries Ltd.*, *supra*, note 136 at 22 B.L.R. (2d) 32-33.

[262] *Themadel*, *supra*, note 76.

[263] For example, see the *Chiaramonte* case, *supra*, note 185 and the *Neri* case, *supra*, note 155. In both cases, there was prior disclosure of the impugned conduct yet it was still held to be oppressive.

(1) Disclosure

Prior disclosure of conduct to a complainant will have a direct bearing on the foreseeability of such conduct. If a complainant is given advance notification that certain conduct is likely to occur, such conduct obviously becomes very foreseeable. In these circumstances, it is less likely that the conduct would be contrary to the complainant's expectations, acting reasonably. The extent of disclosure is important, as is the timing. In the *Watergroup* case,[264] the court held that an interest free loan previously granted to the shareholder of the majority shareholder was not oppressive since it was disclosed to the complainant at the time the complainant purchased the shares.[265] In these types of situations, it would be difficult for a complainant to establish that the loan was not part of the shareholder compact.

If a complainant freely acquiesces in a particular course of conduct for a period of time, it is less likely a court will find such conduct to be oppressive. The *Chiaramonte* case[266] provides an apt example. In that case, one of the complained of actions was the issuance of unequal bonuses. In finding that the unequal bonuses were not oppressive, the court noted that the bonuses had not only been disclosed to the complainants, but were also consented to by the complainants. Therefore regard may be had as to whether the complainant raised any objections or complaints upon learning of the impugned conduct.

It is well accepted that expectations are not a static matter and therefore may change over time.[267] Therefore disclosure subsequent to a complainant's initial involvement with a corporation may also be relevant to a "reasonable expectations" inquiry.

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[264] *Supra*,.note 136.

[265] *Watergroup*, *ibid.* at 271-72.

[266] *Supra*, note 185.

(2) Consistency with Previous Practice

The consistency of conduct with previous practice enhances the foreseeability of such conduct which may prove very relevant to an assessment as to whether an expectation is reasonable. Several case law examples help illustrate the application of this factor.

Previous conduct was a pivotal factor in the case of *Besner* v. *J.A. Besner & Sons (Canada) Ltd.*[268] In this case, the business was originally founded by two brothers, who subsequently involved their sons. For many years, there was equal representation, from both sides of the family, on the corporation's board of directors. During these years, there was a total of four directors. One of the directors then died. The remaining director from that side of the family pursued the calling of a shareholders' meeting to elect a replacement for the deceased director. The other two directors, however, stalled on calling this shareholders' meeting. It was their hope that the previous practice of equal representation from both sides of the family would cease. The court held that the complainant had a legitimate expectation that the practice of equal representation would continue notwithstanding the death of one of the founding directors.[269] Failing to honour this practice amounted to conduct that was in unfair disregard of the complainant's equitable right to equal representation.[270]

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[267] *Chiaramonte, ibid.* at 655; *Ballard, supra*, note 76 at 191. The *Ballard* case involved an estate freeze situation where the shares were initially gifted to the complainant. The fact that shares were originally a gift does not necessarily preclude a shareholder from enjoying the benefits of such share holdings or developing other reasonable expectations in respect thereof. See also *Naneff, supra*, note 141 at 248-49.

[268] (1993), 15 B.L.R. (2d) 261 (Que.S.C.) [hereinafter *Besner*].

[269] *Besner, ibid.* at 277.

[270] *Besner, ibid.* at 277-280.

The cases also support the relevance of previous practice where the impugned conduct involved a complainant's exclusion from management participation. Long term involvement in management may incline a court towards treating this involvement more as a right, rather than merely a privilege. In the *Ballard* case,[271] the court commented that since the applicant had been a director for many years, it would be reasonable for him to expect that he would continue in this position, absent a legitimate justification for removal.[272]

The Ontario Court of Appeal, in the case of *Alldrew Holdings Ltd.* v. *Nibro Holdings Ltd.*[273] considered the corporation's previous conduct when making its assessment as to whether certain actions were oppressive. In this case, one ground of complaint was that the corporation ceased running one of its businesses without first consulting with the complainant. There was nothing in the corporate constitution obligating such a consultation. The complainant was a minority shareholder who had no involvement in management. In rendering its decision that this action was not oppressive, the court noted that the method of making the decision to cease carrying on the business was generally consistent with the previous practice of the corporation.[274]

Consistency with previous practice is one of many features that a court may consider relevant in a particular case. For example, in the *Ludlow* case,[275] payment of an excessive management fee was noted to be inconsistent with previous practice. Yet the court also considered whether there was any valid business reason for the payment before denouncing the conduct as being oppressive.[276] Thus conduct that is inconsistent with previous practice will not necessarily result in automatic liability.[277] There are many situations where a change in previous practice will be justified.[278]

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[271] *Supra*, note 76.

[272] *Ballard*, *ibid.* at 205; *Naneff*, *supra*, note 141 at 247-49. In *Naneff*, the court also noted, at 251, that the dividends granted were not oppressive as there was a "prior pattern" of such payments being made and the amounts thereof were reasonable.

[273] *Supra*, note 136.

[274] The only difference was that the information was intentionally withheld from the complainant until the business had been closed. The court found that there was a valid reason justifying this confidentiality. See also *Naneff* v. *Con-Crete Holdings Ltd.*, *supra*, note 141, where the court found that granting dividends to one of the parties was not oppressive. In making this finding, the court noted that "there was a prior pattern of dividends" to this person: *Naneff* v. *Con-Crete Holdings Ltd.*, *supra*, note 141 at 251.

An analysis of the oppression decisions decided during the second stage suggests that the five factors discussed *supra* are particularly relevant to a "reasonable expectations" inquiry. Unfortunately, there is little express recognition by the judiciary of the prominence of these particular factors. Indeed, the courts have been reluctant to identify any attendant principles to be applied within the confines of the "reasonable expectations" test.

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[275] *Supra*, note 194.

[276] See *supra*, Section II.C.3.c.ii. of this Chapter Two which references the above facts in more detail.

[277] For example, in the *Naneff* v. *Con-Crete Holdings Ltd.* case, *supra*, note 141, it was held that although it was inconsistent with previous practice for the corporation to enter into employment contracts which provided for large salaries, it was not considered to be oppressive in the circumstances. The employment agreements were said to "regularize the corporate relationship" between the companies and the applicable employees: *Naneff* v. *Con-Crete Holdings Ltd.*, *supra*, note 141 at 250-51.

[278] For example, in the *Westfair* case, *supra*, note 3, the corporation changed its long established practice of retaining profits to distributing all such profits each year. Although inconsistent with previous practice, it was not held to be oppressive.

In some cases, a change in established practice is not simply permissible, but necessary, to avoid an oppression claim. The *Loveridge Holdings Ltd.* v. *King Pin Ltd.* case, *supra*, note 206, is an appropriate example. In this case, the court recognized that the respondents had run the company in the same way for several years. The court held, however, that these ways had to change once there was a minority shareholder whose rights were being prejudiced and who had no say in the corporation: *Loveridge Holdings Ltd.* v. *King Pin Ltd.*, *supra*, note 206 at 202.

III. SUMMARY

In Canada, the judicial treatment of the oppression remedy has evolved from the application of a general fairness standard, to the adoption of the "reasonable expectations" test. The "reasonable expectations" test helps to particularize what is fair.

Unfortunately, the Canadian courts have been reluctant to articulate, in sufficient detail, the principles that guide the application of the "reasonable expectations" test. The lack of express commentary mandates one to glean insight, in this regard, from a case law review of the application of the "reasonable expectations" test.

A review of the oppression case law confirms that the "reasonable expectations" test focuses on the underlying agreement amongst the parties. The term "agreement," when used in association with the "reasonable expectations" test, is not solely a creature of contract. Consequently, one is not bound by the traditional rules of contract law when ascertaining the content of the agreement. For the most part, the courts attempt to discern the parties' likely intentions on the matter in issue. This assessment is made based on an examination of the circumstances of the case and relevant corporate norms. In some cases, however, the courts will impose what the court feels is appropriate, without regard to the parties' agreement. These type of cases often involve flagrant misconduct by one or more of the controlling parties which serves to exploit the interests of the minority players.

It is also clear that certain criteria are particularly important when assessing the parties' underlying agreement and accordingly, their reasonable expectations. These criteria are not the only relevant considerations, however they are particularly important. These criteria are as follows:

(a) Is there any written documentation which provides insight on whether the impugned conduct is within the parties' expectations?

(b) How foreseeable was the impugned conduct? The more foreseeable it is, the more likely it will be found to form part of the underlying arrangement. In assessing the foreseeability of the conduct, one should consider whether it is consistent with the previous practice of the corporation and/or whether there was prior disclosure of it to the complainant.

(c) Did the impugned conduct involve an appropriation of corporate assets or corporate opportunities to the detriment of the complainant? If so, the courts are more likely to find that it was contrary to the underlying agreement.

(d) Was the impugned conduct within the appropriate realm of the business judgment rule? The oppression remedy provides protection to minority shareholders. It does not, however, abrogate the legitimate rights of the majority shareholders and management to run the corporation. The business judgment rule represents the rights of these latter two factions. Its relevance confirms the courts' need to balance the often competing interests of the various corporate participants when applying the oppression remedy.

(e) Is the corporation a public corporation with a dominant shareholder and illiquid shares, a public corporation that is widely held, with no dominant shareholder and liquid shares, or a closely held corporation. It is more likely for certain types of expectations to arise in the context of a closely held corporation. For example, shareholder expectations relating to management or employment involvement. As well, the lack of liquidity associated with the shares of closely held corporations renders shareholders of such corporations more vulnerable to exploitation and increases the chances of an oppression claim. The shares of many public corporations suffer from similar illiquidity problems. If the public corporation also has a dominant shareholder, there is significant potential for an oppression claim.

The “reasonable expectations” inquiry focuses on the parties’ underlying compact or arrangement. All of the conclusions referenced above are relevant to a determination of this compact. The cases provide little express recognition of these conclusions. The courts must therefore be encouraged to expressly recognize and discuss these and other principles that are relevant to the application of the “reasonable expectations” test. Both the American experience and economic analysis can provide assistance in this regard. Each of these topics are respectively discussed in Chapter Three and Chapter Four of this thesis.

CHAPTER THREE

MINORITY SHAREHOLDER PROTECTION FROM OPPRESSION IN THE UNITED STATES OF AMERICA

I. THE DIFFERENT TYPES OF MINORITY SHAREHOLDER PROTECTION IN THE UNITED STATES

Many of the major corporate law reforms in Canada, which commenced in the 1970s, drew, in part, on the American corporate law experience.[1] Consequently, corporate law in the United States has provided some useful insight and guidance to corporate law issues arising in Canada. It is therefore worthwhile to briefly review the extent to which American corporate law has adopted a remedy similar to the Canadian oppression remedy.

Prior to undertaking such a review, it is important to note several features about the general legislative and judicial structure of corporate law in the United States. First, in contrast to the Canadian legislative structure, there is no federal legislation in the United States which creates a federal jurisdiction for the incorporation of corporations.[2] Second, the American courts have a "much more activist legal tradition" as compared with the English and Canadian courts.[3] They are less precedent-oriented than their English and Canadian counterparts.[4] A precedent based approach is less reliable in the United States in light of the vast number of American cases and the consequent likelihood that a contrary precedent can generally be found on any issue.[5] As well, very few corporate law cases are appealed beyond the highest court authority in the applicable state.[6] Therefore, for the most part, each state controls the development of their respective corporate laws and is consequently relatively autonomous.[7] The existence of fifty states means it is unlikely one will find a uniform national approach to any corporate law issue. These are important considerations to keep in mind when considering the American corporate law experience. The tendency of the American courts to steer away from precedent and focus on the policy behind the law and the facts of each case,[8] leaves them well equipped to apply an oppression type remedy. It also helps explain why none of the states have found it necessary to adopt the broad wording of the oppression remedy found within the *CBCA*.

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[1] Brian Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988), 10 U.Pa.J. Int. Bus. L. 305 at 307, 309; *Dickerson Report*: R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada*, vol. 1 (Ottawa: Information Canada, 1971) at iv. of Preface; Philip Anisman, "Majority-Minority Relations in Canadian Corporation Law: An Overview" (1986-87) 12 Can. Bus. L.J. 473 at 473-74 n. 2. Cheffins specifically notes that the "two most influential jurisdictions were the United States and, to a lesser extent, England": Cheffins, *supra*, at 307. England provided particular guidance, however, with respect to the adoption of a statutory oppression remedy: Cheffins, *supra*, at 310.

[2] Cheffins, *ibid.* at 306. Of course, there is federal law which impacts on corporations in the United States. However, there is no general federal jurisdiction similar to that found

With respect to minority shareholder protection from oppression, there are both common law principles and statutory provisions that offer protection similar, but not identical, to

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in Canada within which a corporation may incorporate.

[3] Jeffrey G. MacIntosh, with Janet Holmes & Steve Thompson, "The Puzzle of Shareholder Fiduciary Duties" (1991) 19 Can. Bus. Law J. 86 at 89.

[4] MacIntosh, Holmes & Thompson, *ibid.* at 89.

[5] MacIntosh, Holmes & Thompson, *ibid.* at 91.

[6] Roberta Romano, *The Genius of American Corporate Law* (Washington, D.C.: The AEI Press, 1993) at 122; MacIntosh, *supra*, note 3 at 96. In Canada, the Supreme Court of Canada has jurisdiction to review all provincial appellate court decisions: Romano, *supra*, at 123; MacIntosh, Holmes & Thompson, *ibid.* at 96.

[7] MacIntosh, Holmes & Thompson, *ibid.* at 95.

[8] MacIntosh, Holmes & Thompson, *ibid.* at 92, 95.

the Canadian federal oppression remedy. The common law protection is rooted in the fiduciary duty concept. That is, that the majority shareholders owe a fiduciary duty of utmost good faith and loyalty to the minority shareholders in a corporation. This fiduciary obligation is enhanced when the type of corporation is a close corporation.[9] The wording of the statutory protection, not surprisingly, varies considerably depending on the state. Each of the common law and statutory forms of protection are examined in further detail below.

A. Common Law Protection

As noted above, the basis of the common law protection is the fiduciary obligation owed by majority shareholders to minority shareholders.[10] This duty is credited as being a response to the judicial recognition that "the conflict of interest and the ability to work economic harm to the interests of another,"[11] which drive the directors' fiduciary duty, apply to controlling shareholders as well. The general approach appears to be that the fiduciary duty exists regardless of whether the corporation is a close corporation or a public corporation.[12] The obligation, however, is heightened when the corporation is a close corporation.[13] This enhanced obligation is intended to mitigate the increased vulnerability of a minority shareholder in a close corporation.[14] This vulnerability is aptly referenced in the following extract from the case of *Crosby* v. *Beam*.[15] After recognizing the need for the shareholder relationship to be based on the fiduciary notions of trust and loyalty, the Ohio Supreme Court held:

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[9] F. Hodge O'Neal and Robert B. Thompson, *O'Neal's Close Corporations*, 3rd ed., (New York, N.Y.: Clark Boardman Callaghan, 1987, updated to 1997) at 8-85; Robert B. Thompson, "The Shareholder's Cause of Action for Oppression" (1993) 48 The Bus. Lawyer 699 at 726. The term "close" corporation is essentially the American equivalent of the Canadian "closely-held" corporation. Both terms are used somewhat interchangeably in the United States when used in a general sense. Some of the states statutorily define a "close corporation." These definitions are not all identical. For example, in New York, a close corporation is statutorily defined as a corporation whose shares are not traded on a national stock exchange or quoted in an over-the-counter market [N.Y. Bus. Corp. Law § 1104a(a)(1) (McKinney 1986)]. The legislation in New Jersey and Minnesota, however, define it as a corporation that has no more than twenty-five and thirty-five shareholders respectively [N.J. Stat. Ann. § 14A:12-7 (West Supp. 1992); Minn. Stat. Ann. § 302A.751 subd. 2 (West Supp. 1992)]. In Delaware and Maryland, in addition to meeting certain other requirements, a close corporation must also make a specific election to that effect in its articles of incorporation [Del. Code Ann. tit 8 § 343, 344; Md. Corps & Ass'ns Code § 4-201].

[10] J.A.C. Hetherington, "Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities" (1987) 22 Wa. For. L.R. 9 at 12; MacIntosh, Holmes & Thompson, *supra*, note 3 at 86. The fiduciary duty is generally stated as being imposed on the majority or controlling shareholders, as opposed to all shareholders. There appears to be some controversy in the case law as to whether this fiduciary obligation is on all shareholders or simply majority or controlling shareholders. It is likely that a minority shareholder will have this duty if the minority shareholder has sufficient managerial

> While a close corporation provides the same benefits as do other corporations, such as limited liability and perpetuity, the close corporation structure also gives majority or controlling shareholders opportunities to oppress minority shareholders. For example, the majority or controlling shareholders may refuse to declare dividends, may grant majority shareholders-officers exorbitant salaries and bonuses, or pay high rent for

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control or joins together with other shareholders to form a majority. It is unnecessary, for the purposes of this thesis, to further analyze or reconcile the case law in this regard. See O'Neal and Thompson, *ibid.* at 19-20 of 1997 Vol. 1 Suppl., 10 of 1997 Vol. 2 Suppl. and 8-96 n. 12.

[11] MacIntosh, Holmes & Thompson, *ibid.* at 99.

[12] Gordon Phillips, *Personal Remedies for Corporate Injuries* (Toronto: Carswell, 1992) at 120; MacIntosh, Holmes & Thompson, *supra*, note 3 at 86.

[13] O'Neal & Thompson, *supra*, note 9 at 1-112, 113; Thompson, *supra*, note 9 at 726-27; James D. Cox, *Quick Review: Corporations* (United States: Sum and Substance, 1993) at 46. The business judgment rule carries greater weight when it is a public corporation. The market serves as a check on managerial decisions thereby rendering the business judgment rule less of a concern for minority shareholders of public corporations: O'Neal & Thompson, *supra*, note 9 at 20-21 of 1997 Vol. 1 Suppl. and 1-124, 125.

[14] See O'Neal & Thompson, *ibid.* at 8-67 - 77 for a detailed discussion of such vulnerability. Also see the other references *ibid.*

[15] 548 N.E. 2d 217 (1989).

> property leased from the majority shareholders.
>
> Minority shareholders in a close corporation, denied any share of the profits by the majority shareholder's action, will either suffer a loss or try to find a buyer for their stock. This situation is contrasted with an oppressed minority shareholder in a large publicly owned corporation who can more easily sell his shares in such a corporation. Generally, there is no ready or available market for the stock of a minority shareholder in a close corporation. This presents a plight for a minority shareholder in a close corporation who can become trapped in a disadvantageous situation from which he cannot be easily extricated.[16]

This excerpt is also revealing for its reference to oppression when determining whether the shareholder fiduciary duty had been breached.

There are two cases, decided by the Massachusetts Supreme Judicial Court, which are often cited in association with the fiduciary duty principle.[17] These cases are *Donahue* v. *Rodd Electrotype Co.*[18] and *Wilkes* v. *Springside Nursing Home, Inc.*[19] In the *Donahue* case, the court held that the stockholders had an enhanced fiduciary duty of "utmost good faith and loyalty" to each other that was similar to that owed amongst partners in a partnership.[20] The strong wording used in the *Donahue* case in association with the fiduciary obligation was tempered somewhat in the *Wilkes* case.[21] In the *Wilkes* case, although the court recognized the enhanced fiduciary notion in the context of close corporations, it held that this obligation must be considered in conjunction with the business judgment rule.[22] That is, due regard should be given to whether there was a legitimate business purpose for the action and the viability of a less harmful alternative.[23] In both cases, liability was found on the basis that the conduct breached an implied understanding between the parties.[24] Therefore a "reasonable expectations" analysis is relevant to the application of the shareholder fiduciary duty doctrine.[25]

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[16] *Crosby* v. *Bean, ibid.* at 220.

[17] Thompson, *supra*, note 9 at 726-728, 739. See also Lynden Griggs and John P. Lowry, "Minority Shareholder Remedies: A Comparative Review" [1994] J.B.L. 463 at 485-86.

[18] 328 NE2d 505, 367 Mass 578, (1975) [hereinafter *Donahue* cited to NE2d].

[19] 353 NE2d 657, 370 Mass 842 (1976) [hereinafter *Wilkes* to NE2d].

[20] Dennis Campbell & Sheila Buckley, eds. *Protecting Minority Shareholders* (London, Eng.: Kluwer Law International, 1996) at 653.

[21] *Ibid.* at 653.

The application by the American courts of this enhanced fiduciary duty has not been uniform.[26] Some courts have adopted the *Donahue* standard, while others have modified the *Donahue* approach by limiting its application in the way set forth by the *Wilkes* case or otherwise.[27] Notwithstanding this varied approach, there exists broad acceptance in the United States of this enhanced fiduciary duty in the close corporation context.[28]

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[22] *Wilkes*, *supra*, note 19 at 663.

[23] Campbell & Buckley, *supra*, note 20 at 653. The *Wilkes* case involved four shareholders, one of whom was terminated from his employment with the corporation after fifteen years of service and was otherwise precluded from making a return on his investment in the company. The court held that the remaining three shareholders had breached their fiduciary duty to the fourth shareholder.

[24] Hetherington, *supra*, note 10 at 25 - 28. Therefore in the *Wilkes* case, the business purpose was not sufficient to justify the impugned conduct. This approach resembles the application of the "reasonable expectations" test in Canada in the sense that the business judgment rule is one of several relevant factors to consider. See also Cox, *supra*, note 13 at 47.

[25] See *infra*, Section II. of this Chapter Three for a further discussion of the use of the "reasonable expectations" test in association with the shareholder fiduciary duty concept.

[26] Thompson, *supra*, note 9 at 728-29; Campbell & Buckley, *supra*, note 20 at 653.

[27] O'Neal & Thompson, *supra*, note 9 at 8-88, 89; Thompson, *supra*, note 9 at 728.

[28] O'Neal & Thompson, *ibid.* at 8-89; Thompson, *ibid.* at 729.

B. Statutory Protection

The majority of the states have now adopted oppression legislation.[29] The oppression provisions are generally located in a state's corporate dissolution legislation. It forms one of the grounds upon which one could petition for a judicial dissolution or alternative relief.[30] The legislative wording of this oppression ground varies depending on the state. Some states do not even include the term "oppression" in such legislation.[31] For the sake of simplicity, however, unless specifically noted, the term "oppression" will be used herein to reference all such relevant legislation.

In the United States, as in Canada, an order for involuntary dissolution has always been regarded as a very drastic remedy.[32] After the corporate dissolution remedy was broadened by including grounds such as oppression, the courts also began to order alternative forms of relief in circumstances where oppression had been established yet the judicial dissolution of a corporation was considered too harsh.[33] In ordering such alternative relief, the courts have relied either on statutory authorization, where applicable, or alternatively, on general powers of equity.[34] The increased willingness of the courts to grant alternative relief had a positive impact on the development and enforcement of the oppression ground. Courts were more inclined to find oppression since they were not restricted to ordering the drastic winding up remedy in the event oppression was found.[35]

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[29] See *infra*, notes 39 - 42 and accompanying text.

[30] Robert B. Thompson, "Corporate Dissolution and Shareholders' Reasonable Expectations" (1988) 66 Wash. U.L.Q. 193 at 206, 228. The most common types of alternative relief include: the appointment of a custodian, the appointment of a provisional director, the buy out of a shareholder, a change in the constating documentation of a corporation: Thompson, *supra*, at 228.

[31] Thompson, *ibid.* at 205-206.

[32] C. Capel, "Corporation Law - *Meiselman v. Meiselman*: "Reasonable Expectations" Determine Minority Shareholders' Rights" (1984) 62 N.C.L.R. 999 at 1006; O'Neal & Thompson, *supra*, note 9 at 9-113; Cheffins, *supra*, note 1 at 309; J.A.C. Hetherington & Michael P. Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem" (1977) 63 Va. L. Rev. 1 at 26. The Canadian decisions of *Mason* v. *Intercity Properties Ltd.* (1987), 38 D.L.R. (4th) 681, 59 O.R. (2d) 631, 37 B.L.R. 6 (C.A.), leave to appeal to the S.C.C. refused 42 D.L.R. (4th) viii., 62 O.R. (2d) ix., 87 N.R. 73*n*, and *Abraham* v. *Inter Wide Investments Ltd.* (1985), 20 D.L.R. (4th) 267, 51 O.R. (2d) 460, 30 B.L.R. 177 (H.C.J.), supplementary reasons at 55 D.L.R. (4th) 377, 62 O.R. (2d) 684, var'd as to valuation (1988), 55 D.L.R. (4th) 377, 66 O.R. (2d) 684, confirm the extreme nature of the remedy.

The oppression provisions therefore originated as simply an additional ground for involuntary dissolution. While they are still generally found within the dissolution statutes of most states, oppression has essentially evolved into an important remedy in its own right for minority shareholder protection.[36]

In some states, oppression has appeared as a ground for involuntary dissolution from at least as early as the 1930s.[37] The first Model Business Corporation Act in 1946, which was developed by a committee of the American Bar Association, also included it as a ground.[38] Although such model acts are not official statutes, they serve as useful references for the development of statutory schemes in each of the states. Currently, at least thirty-seven of the fifty states have oppression legislation.[39] Thirty-one of these states use the term "oppression."[40] Four of the thirty-seven states use the phrase "unfairly prejudicial" or similar language instead of the term "oppression."[41] Of the remaining states, several allow relief for illegality or fraud, but not for oppression.[42]

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[33] Thompson, *supra*, note 30 at 228.

[34] Thompson, *supra*, note 9 at 708. See also Thompson, *ibid.* at 231 wherein he discusses a group of states who, without statutory authorization, grant the buy out remedy "on the basis of their general equity powers." South Carolina was one of the forerunner states which did not require proof of entitlement to dissolution before oppression could be found. As well, it provided a non-exhaustive list of potential remedies that could be ordered if oppression were found. See Allen B. Afterman, "Statutory Protection for Oppressed Minority Shareholders: A Model for Reform" (1969) 55 Va.L.R. 1043 at 1072-76 for further discussion on the South Carolina statute.

[35] Ian Ayres, "Judging Close Corporations in the Age of Statutes" (1992) 70 Wash. U. Law Q. 365 at 391; Thompson, *supra*, note 30 at 228.

[36] Thompson, *supra*, note 9 at 708-09. This is distinct from the Canadian experience. In Canada, this ancillary role was avoided because from the outset, the oppression remedy in the *CBCA* was set out as its own remedy, together with a non-exhaustive list outlining the types of relief that could be ordered to rectify the improper conduct.

Minnesota's statute incorporates one of the broadest formulations of the oppression legislation in the United States, however certain aspects are only applicable to close corporations.[43] It uses the phrase "unfairly prejudicial" instead of the term "oppression."[44] The state of Delaware, on the other hand, represents the other extreme. The state of Delaware is a very popular choice for incorporation among American corporations because its corporate laws emphasize managerial flexibility and discretion.[45] Delaware has consequently been reluctant to adopt oppression legislation which could detract from this emphasis.[46] Limited protection has been provided through legislation which allows for the appointment of a custodian or provisional director in the event of shareholder dissension.[47] The latter appointment is only available if the corporation has elected to be a close corporation in its articles.[48] The election requirement may render the remedy of little use to a minority shareholder. One of the concerns driving the oppression remedy stems from the minority shareholder's inability to obtain, or foresee the need for, protection. It is therefore as unlikely for a minority shareholder to insist on this election as it is for the controllers to voluntarily invite the application of additional remedies by making the election on their own accord.

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[37] For example, in Illinois and Pennsylvania: 1933 Illinois Laws, p. 308, § 86 and 1933 Pennsylvania Laws, #106, § 1107, PL 364. In California, it was included in the 1931 California Civil Code § 404 (1931) but was subsequently removed in 1933.

[38] See section 89 of the proposed *Business Corporation Act* contained within the "Report of the Committee on Corporation Law" in Proceedings of the American Bar Association Section of Corporation, Banking and Mercantile Law at the Annual Meeting in Atlantic City, N.J. (Oct. 28-29, 1946).

[39] Thompson, *supra*, note 9 at 709-10.

[40] Thompson, *ibid.* at 709. For example: Colorado [Colo. Rev. Stat. § 7-8-113 (1986)], Illinois [Ill. Ann. Stat. ch. 32, para. 12.50 (Smith-Hurd Supp. 1992)], New York [N.Y. Bus. Corp. Law § 1104-a(a)(1) (McKinney 1986)], Oregon [Or. Rev. Stat. § 60.661 (1992)], Montana [Mo. Ann. Stat. § 351.494 (Vernon 1991)] and South Carolina [S.C. Code Ann. § 33-14-300 (Law. Co-op. 1990)]. Several states, such as South Carolina, also use the phrase "unfairly prejudicial." For some of these states, the "unfairly prejudicial" ground is restricted to statutory close corporations. Montana's legislation provides one example of this latter situation.

[41] Thompson, *ibid.* at 710. These four states are Alaska [Alaska Stat. § 10.06.628 (1989)], California [Cal. Corp. Code § 1800 (West 1990)], Minnesota [Minn. Stat. Ann. § 302A.751 (West Supp. 1992)] and North Dakota [N.D. Cent. Code § 10-19.1-115 (1985[illegible].

[42] For the names of these states, see Thompson, *ibid.* at 710.

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[43] Cheffins, *supra*, note 1 at 318. As previously noted, close corporations are defined in Minnesota's legislation as corporations which have no more than 35 shareholders.

[44] Minn. Stat. Ann. § 302A.751 (West. Supp. 1992).

[45] Romano, *supra*, note 6 at 125; Thompson, *supra*, note 9 at 738; Campbell & Buckley, *supra*, note 20 at 610.

[46] Delaware derives a large part of its revenue from corporate charters. Accordingly, it is likely to retain a corporate legislative environment that will continue to attract corporations: Larry E. Ribstein, "Efficiency, Regulation and Competition: A Comment on Easterbrook and Fischel's *Economic Structure of Corporate Law*" (1992) 87 Nw.U.L.Rev. 254 at 265-66. This type of environment would generally favor the interests of majority shareholders and management since they usually direct the choice of incorporation.

[47] O'Neal &. Thompson, *supra*, note 9 at 9-155, 156. See Del. Code Ann. tit 8 § 226(a), 352(a) & (b).

[48] O'Neal & Thompson, *ibid.* at 9-155, 156. See Del. Code Ann. tit 8 § 226(a), 352(a) & (b).

For the most part, the statutory wording for oppression used in most states is not as broad as that of the oppression remedy found within the *CBCA*.[49] Broader wording, however, appears to be unnecessary.[50] The American courts appreciate the types of concerns the remedy was intended to target and therefore have interpreted the legislation accordingly.[51] These concerns typically arise in the context of close corporations.[52] Some states restrict the availability of the oppression remedy to close corporations only.[53] One might theorize that this restricted focus made it easier for the courts to understand the potential vulnerability of minority shareholders in close corporations and accordingly better appreciate the need for the remedy. This explanation is not overly compelling however, since most other states contain no such restriction in their legislation.[54]

In any event, the three main grounds the American courts have used to define oppression confirm that the narrower legislative wording has had little impact on the practical application of the remedy. The three main bases for finding oppression are as follows:[55]

(a) Conduct that is burdensome, harsh and wrongful, or conduct which constitutes a "visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely";[56]

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[49] For example, many of the states do not use the phrase "unfairly prejudicial" as a defining element or as an additional ground for relief.

[50] But see Cheffins, *supra*, note 1 at 339 where he advocates the adoption of a more broadly worded oppression remedy similar to the statutory oppression remedy found within the *CBCA*.

[51] Thompson, *supra*, note 9 at 713.

[52] Cheffins, *supra*, note 1 at 317-18. See also Thompson, *ibid.* at 701-703, 713; Thompson, *supra*, note 30 at 194-199; Capel, *supra*, note 32 at 1003-05.

[53] For example, New Jersey [N.J. Stat. Ann. § 14A:12-7 (West Supp. 1992)] and New York [N.Y. Bus. Corp. Law § 1104-a(a)(1) (McKinney 1986)].

[54] O'Neal & Thompson, *supra*, note 9 at 9-137 n. 9; Thompson, *supra*, note 30 at 225.

[55] Thompson, *supra*, note 9 at 711-12; Campbell & Buckley, *supra*, note 20 at 640.

(b) Conduct that constitutes a breach of the fiduciary duty of good faith and fair dealing owed by the majority shareholders to the minority shareholders; and

(c) Conduct which amounts to a frustration of the reasonable expectations of the complainant shareholder.

These three bases are not exclusive nor do all three have to be satisfied. The same conduct often may violate more than one standard. Also, it is worth noting the association of the controlling shareholder's common law fiduciary duty with the statutory oppression remedy. This will be reviewed in further detail *infra*.

When considering the application of the oppression remedy, the courts in the United States, as in Canada, continue to recognize the importance of the business judgment rule.[57] Notwithstanding the existence and relevance of this rule, it has not unduly restrained the application of the oppression remedy by the American courts.[58]

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[56] Thompson, *ibid.* This approach follows the early English jurisprudence on oppression. It essentially echoes the wording used in the cases of *Elder* v. *Elder & Watson* (1952) Sess. Cas. 49 at 55 and *Scottish Co-op Wholesale Society* v. *Meyer* [1958] 3 All E.R. 66 at 86. See also Cheffins, *supra*, note 1 at 320 and Griggs & Lowry, *supra*, note 17 at 484. Canadian judges have also followed the English jurisprudence when determining the meaning of the "oppression" ground. As well, the *Dickerson Report*, *supra*, n. 1 at para. 485, referenced an excerpt from the *Elder* v. *Elder & Watson* case, *supra*, to describe the general type of conduct the oppression remedy was intended to proscribe. This excerpt was very similar to the portion set out in quotes in the text accompanying this note. See *supra*, Chapter Two of this thesis for additional information on the Canadian situation.

[57] Cheffins, *ibid.* at 328 n. 97; O'Neal & Thompson, *supra*, note 9 at 1-124, 125. O'Neal and Thompson's book notes that the two doctrines which inhibited judicial interference were the principles of majority rule and the business judgment rule. The latter rule is said to be based mainly on the right of the majority to govern, which overlaps with the first rule, as well as the fact the courts do not have the requisite expertise to justify the replacement of their business judgments with the judgment of experts. These doctrines of majority rule and the business judgment rule essentially parallel the Canadian doctrines of majority rule and separate legal personality (internal autonomy), respectively, which are described *supra*, in Chapter One of this thesis. The author prefers to use the phrase "the business judgment rule" to represent both of these principles. In light of this preference, the practice will continue throughout this Chapter Three such that any reference to the business judgment rule will include both underlying principles.

II. “REASONABLE EXPECTATIONS” ANALYSIS

The “reasonable expectations” analysis has also gained popular recognition in the United States.[59] Professor F. Hodge O’Neal, a well respected American legal scholar who has devoted considerable attention to minority shareholder oppression and close corporations,[60] advocated the use of the “reasonable expectations” test as early as 1975.[61] His writings have served as a guiding force for the courts in the subsequent adoption of the “reasonable expectations” standard.[62] The “reasonable expectations” test was viewed as providing a more concrete standard for the resolution of shareholder disputes.[63] The acceptance of this test in the United States predated the Canadian "reasonable expectations" movement. By 1988, the highest appellate courts in at least six states had already adopted this standard.[64] As well, several states have now incorporated the "reasonable expectations" inquiry directly into their oppression legislation.[65]

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[58] Cheffins, *ibid.*

[59] Thompson, *supra*, note 30 at 211; Thompson, *supra*, note 9 at 715-718; Griggs & Lowry, *supra*, note 17 at 484-85. For example, in the case of *In Re Kemp & Beatley, Inc.* 64 N.Y.2d 63 at 72-73, 473 N.E.2d 1173 at 1179, 484 N.Y.S.2d 799 at 805 (1984), the New York Court of Appeals held:

> Given the nature of close corporations and the remedial purpose of the statute,... utilizing a shareholder's “reasonable expectations” as a means of identifying and measuring conduct alleged to be oppressive is appropriate.

Thompson also agrees with the appropriateness of a “reasonable expectations” approach. See Thompson, *supra*, note 30 at 237-38.

[60] Thompson, *ibid.* at 193.

[61] F.Hodge O’Neal, *“Squeeze-outs” of Minority Shareholders* (New York: Callaghan & Company, 1975) (commonly cited as *Oppression of Minority Shareholders*) as revealed in the following excerpt (at 525):

> The reasonable expectations of the shareholders, as they exist at the inception of the enterprise, and as they develop thereafter through a course of dealing concurred in by all of them, is perhaps the most reliable guide to a just solution of a dispute among shareholders, at least a dispute among shareholders in the typical close corporation.

[62] Thompson, *supra*, note 30 at 213-215; Capel, *supra*, note 32 at 1010. For example, see *Topper* v. *Park Sheraton Pharmacy, Inc.* 107 Misc. 2d 25 at 32-33, 433 N.Y.S. 2d 359 at 364-65 (N.Y. Sup. Ct. 1980).

The North Carolina Supreme Court case of *Meiselman* v. *Meiselman*,[66] decided in 1983, is credited with giving particular notoriety to the "reasonable expectations" analysis.[67] In this case, the wording of the relevant statute required the court to determine whether liquidation was "reasonably necessary for the protection of the rights or interests of the complaining shareholders."[68] This case accepted the "reasonable expectations" test advocated by Professor O'Neal as an appropriate guide when making this assessment.[69]

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[63] O'Neal & Thompson, *supra*, note 9 at 9-133; Hetherington, *supra*, note 10 at 24-25.

[64] The six states were Alaska, Montana, New York, North Carolina, North Dakota and West Virginia: Thompson, *supra*, note 9 at 715-16. The adoption of the "reasonable expectations" test happened fairly quickly since the first American cases to start utilizing the concept seem to date from approximately 1980: Donald F. Clifford, Jr. "Close Corporation Shareholder Reasonable Expectations: The Larger Context" (1987) 22 Wake Forest L.R. 41 at note 2; Thompson, *supra*, note 30 at 211. However, Afterman opined that there was implicit acceptance of this type of inquiry by some American courts at least a decade earlier. See Afterman, *supra*, note 34 at 1063 n. 88.

[65] For example, Minnesota in 1983 [Minn. Stat. Ann. § 302A.751 subd. 3a (West Supp. 1992)] and North Dakota in 1986 [N.D. Cent. Code § 10-19.1-115 (1985)]. See *infra*, note 88 and accompanying text for the specific wording of the "reasonable expectations" portion of the Minnesota legislation.

[66] 309 N.C. 279, 307 S.E.2d 551 (1983) [hereinafter *Meiselman*].

[67] Thompson, *supra*, note 30 at 215. This was one of the first American decisions to extensively analyze a statutory provision allowing for the protection of minority shareholder interests: Capel, *supra*, note 32 at 1012-13.

[68] N.C. Gen. Stat. § 55-14-30 (1990).

[69] *Meiselman*, *supra*, note 66, N.C. at 298, S.E.2d at 563.

The adoption of the "reasonable expectations" test properly directs the inquiry to the *effect* of the conduct on the complaining shareholder.[70] This is in contrast to the traditional approach of the courts which was to focus on whether the nature of the conduct by the majority was wrongful.[71] The court in *Meiselman* held that a minority shareholder may have a reasonable expectation as to employment or involvement in management, even though there is no written agreement documenting such an expectation.[72] In this regard, it was noted that rarely will there be such an agreement due to lack of foresight or bargaining power.[73]

In the United States, as in Canada, the basis of the "reasonable expectations" test is the underlying agreement amongst the participants.[74] The *Meiselman* case, in the following commentary, identifies the underlying agreement as the focus of the "reasonable expectations" inquiry, and highlights certain other factors relevant to the inquiry:

> These "reasonable expectations" are to be ascertained by examining the entire history of the participants' relationship. That history will include the "reasonable expectations" created at the inception of the participants' relationship; those "reasonable expectations" as altered over time; and the "reasonable expectations" which develop as the participants engage in a course of dealing in conducting the affairs of the corporation. The interests or views of the other participants must be considered in determining "reasonable expectations." The key is "*reasonable.*" In order for a plaintiff's expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them. Privately held expectations which are not made known to the other participants are not "reasonable." Only expectations embodied in the understandings, express or implied, among the participants should be recognized by the

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[70] Capel, *supra*, note 32 at 1011; Thompson, *supra*, note 30 at 215.

[71] Capel, *ibid.* at 1011; Thompson, *ibid.* at 215.

[72] *Meiselman*, *supra*, note 66, N.C. at 289-90, S.E.2d at 558.

[73] *Meiselman*, *ibid.*, N.C. at 291, S.E.2d at 558.

[74] O'Neal & Thompson, *supra*, note 9 at 9-133, 143; Hetherington, *supra*, note 10 at 25.

court.[75]

Certain additional considerations, which have been gleaned from an analysis of the American jurisprudence, provide further guidance for the application of the "reasonable expectations" doctrine in the United States. These considerations are as follows:[76]

(a) the expectations do not have to be in writing;

(b) the expectations must be material to the plaintiff's involvement in the corporation;

(c) the expectations must be known to or assumed by the other parties and concurred in by them;

(d) the bargain or expectations may change over time therefore one must consider the expectations that existed at the inception of the plaintiff's involvement in the enterprise and their evolvement thereafter;

(e) an expectations inquiry shifts the focus from the nature of the defendant's conduct toward the effect of the conduct on the plaintiff's rights and interests; and

(f) the conduct of the plaintiff may affect the remedy.[77]

For the most part, these considerations are equally relevant in Canada. The only consideration that may be somewhat overstated in the Canadian, and likely also in the American, context is the comment that the expectations must be known to, or assumed by, the other parties and concurred in by them. This consideration is suggestive of a requisite degree of agreement which may not be typical or necessary. Many situations will be unforeseen such that the attendant expectations may not arise until such event occurs. As well, in some cases, matters previously agreed to may not necessarily govern.

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[75] *Meiselman*, *supra*, note 66, N.C. at 298, S.E.2d at 563.

[76] Thompson, *supra*, note 30 at 216-219. Several of these are also mentioned in the text accompanying *supra*, note 75.

[77] The specific effect that a plaintiff's conduct will have on the ascertainment of an oppression claim and on the type of relief to be granted remains unclear. See also Cheffins, *supra*, note 1 at 316 n. 40.

Instead, the courts may impose terms that are more in keeping with standard corporate norms or the general norm of fairness.

The foregoing comments in relation to the "reasonable expectations" test provide *some* information on its application. A more in-depth analysis of the test remains necessary to provide better insight into, and more concrete guidance for, its application in the United States.

Support for the "reasonable expectations" test is more commonly found in the oppression case law as opposed to the shareholder fiduciary duty case law. However, support for the test can still be found in the fiduciary duty case law. In fact, several of the cases often credited with forming the basis of the shareholder fiduciary duty have been interpreted as being decided on the basis of an implied understanding amongst the corporate participants.[78] This implied understanding represents the essence of the "reasonable expectations" test. There is also more explicit support for the "reasonable expectations" test in the fiduciary duty context.[79] A "reasonable expectations" approach to the application of the shareholder fiduciary duty has been viewed as a "more precise and accurate tool"[80] for determining the scope of this duty.[81] As well, the varied limits that have been imposed on the fiduciary doctrine have been characterized as representing a "balancing of interests amongst the participants in corporate enterprises" which are

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[78] Hetherington, *supra*, note 10 at 28.

[79] O'Neal & Thompson, *supra*, note 9 at 52 of 1997 Vol. 2 Suppl.

[80] Hetherington, *supra*, note 10 at 39.

[81] Hetherington, *ibid.* at 26, 38-40. The test's focus on the underlying agreement is considered preferable to the notoriously vague fiduciary duty concept because it provides more concrete application parameters and it more accurately reflects the different corporate realities: Hetherington, *ibid.* at 38-39.

"consistent with the interests and *ex ante* expectations of investors."[82] Support for the "reasonable expectations" test can therefore be found in both the statutory and common law approaches to minority shareholder protection in the United States.

III. CONVERGENCE OF THE STATUTORY AND COMMON LAW APPROACHES TO MINORITY SHAREHOLDER PROTECTION

The statutory oppression remedy and the fiduciary duty concept have significantly enhanced the position of the minority shareholder in American corporate law. Although they remain independent doctrines:

> ...their purposes and effects, however, are so sufficiently similar that it makes sense to think of them as two manifestations of a minority shareholder's cause of action for oppression.[83]

The convergence of these two doctrines is supported by their overlapping requirements.[84] With respect to the "reasonable expectations" test, as discussed *supra*, support for the test can be found in both approaches. As well, there is mutual cross referencing of the two doctrines in the cases.[85] In the fiduciary duty context, the reference to oppression was noted *supra* when discussing the case of *Crosby* v. *Bean*.[86] Likewise, many of the statutory oppression cases have held that one of the grounds upon which a claim for statutory oppression may be based is breach of the shareholder fiduciary duty.[87] The relevance of this fiduciary concept when making an assessment as to whether there has been oppression has been statutorily codified in several states. For example, Minnesota's statute states that when making a determination as to whether relief should be granted, the court should consider:

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[82] Hetherington, *ibid.* at 14.

[83] Thompson, *supra*, note 9 at 700.

[84] O'Neal & Thompson, *supra*, note 9 at 8-85,86; Hetherington, *supra*, note 10 at 28.

[85] For example, the oppression cases will refer to fiduciary obligations. Likewise, the fiduciary duty cases will refer to oppression when describing the conduct that is proscribed by the common law remedy.

[86] *Supra*, notes 15, 16 and accompanying text.

> ... the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation and the reasonable expectations of the shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.[88]

The convergence of these two doctrines is further encouraged by the similar abuses at which both doctrines are aimed. As well, it is interesting to note that the fiduciary duty concept has received particular recognition in states which do not contain a statutory oppression remedy.[89] Similarly, states with broad statutory coverage have sometimes shown a reluctance to focus on the fiduciary concept.[90] For now, however, the concepts remain independent doctrines. In states where both remedies are available, the factual circumstances of the case, or procedural matters, may dictate which remedy to pursue.[91] In any event, notwithstanding their distinct origins and existence, these two approaches form the basis of the oppression cause of action for minority shareholders in the United

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[87] See *supra*, note 55 and accompanying text.

[88] Minn. Stat. Ann. § 302A751 (West Supp. 1992). Similar language is found within North Dakota's statute [N.D. Cent. Code § 10-19.1-115 (1985)].

[89] Thompson, *supra*, note 9 at 739. For example, the state of Massachusetts, from which the decisions of *Donahue*, *supra*, note 18 and *Wilkes*, *supra*, note 19 arose, only allows involuntary dissolution if there is deadlock [Mass. Gen. Laws Ann. ch. 156B, § 99 (West 1992)].

[90] Thompson, *ibid.* at 739-40.

[91] Thompson, *ibid.* at 740.

States.[92]

IV. COMPARISON OF THE AMERICAN AND CANADIAN APPROACHES TO MINORITY SHAREHOLDER PROTECTION

The need for fairness in corporate affairs was recognized in the United States earlier than in Canada.[93] The oppression legislation adopted in most of the Canadian jurisdictions, however, had much broader wording than the oppression legislation in the United States. Also, in contrast with the United States, the Canadian courts have generally held that there is no common law fiduciary duty owed by majority or controlling shareholders to minority shareholders.[94] As noted *supra*, in Section III of this Chapter Three, the fiduciary duty concept is more developed in those states that do not have oppression legislation. Therefore, for comparison purposes, the lack of it in Canada is arguably of little consequence given that most Canadian jurisdictions have adopted oppression legislation.[95]

A more significant difference between United States and Canada is the type of public corporation that predominates in each country. This difference has a direct impact on the applicability of the oppression remedy to public corporations. In the United States, most public corporations are widely held with no dominant shareholder.[96] The lack of a dominant shareholder reduces the likelihood that shareholder conflict will occur.[97] Also, the United States has a larger population base to draw from and more financial resources available for investment. These features generate a stronger trading record for many of the public corporations and thereby strengthen the liquidity of their shares. Oppression type situations are consequently less likely to occur in the typical American public corporation. Even if oppression does occur in these corporations, the liquid nature of their shares renders it more likely that the disgruntled shareholders will simply sell their shares, rather than expend the time and incur the expense associated with making an oppression claim. Therefore it is not surprising that, in the United States, the oppression remedy is generally considered to be a remedy almost exclusively for close corporations.[98]

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[92] O'Neal & Thompson, *supra*, note 9 at iv. of Preface to 1997 Vol. 1 Suppl. and 8-85, 86. Also, see *supra*, note 83 and accompanying text.

[93] John J. Chapman, "Corporate Oppression, Structuring Judicial Discretion" (1996) 18 Adv. Q. 170 at 177.

[94] MacIntosh, Holmes & Thompson, *supra*, note 3 at 86, 100.

[95] The author is not suggesting that the Canadian oppression remedy is the same as imposing a fiduciary duty on controlling or minority shareholders. This topic is beyond the scope of this thesis. Instead, the author is merely recognizing that the American literature and case law tend to view the American fiduciary duty imposed on controlling shareholders as being similar to the statutory ground of oppression found in the legislation of many American states.

The Canadian situation is much different. The majority of the public corporations in Canada have a dominant shareholder and are infrequently traded.[99] Accordingly, there is an increased likelihood for shareholder conflicts to arise in these types of illiquid public corporations.[100] As a result, it would be inappropriate and a grave mistake to adopt the American approach which essentially confines the oppression remedy to closely held corporations. In Canada, restricting the oppression remedy to closely held corporations would cause equally worthy oppression situations in public corporations to go unsanctioned. Overall, this type of restriction would undermine the effectiveness of the oppression remedy in Canadian corporate law.

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[96] MacIntosh, Holmes & Thompson, *supra*, note 3 at 86.

[97] MacIntosh, Holmes & Thompson, *ibid.* at 86.

[98] Thompson, *supra*, note 9 at 745 (and generally).

[99] Ronald J. Daniels & Jeffrey G. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime" (1991) 29 Osgoode Hall L.J. 863 at 877-78.

[100] See MacIntosh, Holmes & Thompson, *supra*, note 3 at 87 where they emphasize how the existence of a controlling shareholder enhances the likelihood of shareholder conflicts.

Notwithstanding the foregoing differences, both Canada and the United States have adopted a "reasonable expectations" approach to help guide the oppression inquiry. In this regard, the United States was well ahead of Canada. In Canada, the acceptance of the "reasonable expectations" test did not begin to flourish until well into the nineties. Yet in the United States, by 1988, the highest appellate courts in at least six states had already upheld a "reasonable expectations" standard.[101]

While the United States case law, from as early as 1988, agreed that the "reasonable expectations" test required one to focus on the relationship and understanding between the parties, the parameters of the "reasonable expectations" doctrine remained unclear.[102] Considerable headway has still not been made in further defining these contours. The proper orientation of the inquiry is clear, yet the principles that are to be balanced or addressed when evaluating the reasonableness of an expectation remain murky. As well, the American courts have shown a general tendency not to categorize the cases on the basis of conduct or otherwise.[103] This is consistent with the appreciated need to consider the individual facts of each case when assessing a plaintiff's reasonable expectations.[104] It also reaffirms the need to focus on the effect of the conduct rather than its nature. It is more difficult, however, to categorize cases with respect to the effect of the conduct, except in a very general sense.[105]

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[101] See *supra*, Section II of this Chapter Three.

[102] Clifford, Jr. *supra*, note 64 at 41, 54-55; Brian Cheffins, "An Economic Analysis of the Oppression Remedy: Working Towards a More Coherent Picture of Corporate Law" (1990) 40 U.T.L.J. 775 at 782.

[103] Cheffins, *supra*, note 1 at 322, 323.

[104] Peter A. Tannenbaum, "Shareholder Agreements - Oral Agreements in Close Quarters - *Penley* v. *Penley*" (1987) 22 Wake Forest L. Rev. 147 at 165.

The American use of the "reasonable expectations" test resembles, to a large extent, both the status of the "reasonable expectations" test in Canada and the Canadian judiciary's approach to its application. In both countries, there is little judicial comment on the structure and content of the "reasonable expectations" test. However, the American use of the "reasonable expectations" test is more developed in several respects.

First, the United States' judiciary recognizes that the focus of the "reasonable expectations" test is the underlying arrangement amongst or between the parties. The Canadian courts tend not to explicitly emphasize this focus.

Second, the American courts seem to have a better appreciation of the concerns prompting the need for the oppression remedy.[106] This goes beyond merely recognizing the need for fairness in corporate affairs. The American judiciary is more sensitive to how unfair situations may manifest themselves in the corporate context.[107] It is well understood by the American courts that the requisite discretion and control afforded management and the controlling shareholders render minority shareholders more vulnerable, particularly when the corporation is closely held. This comprehensive appreciation helps guide the application of the "reasonable expectations" test. It directs the inquiry towards the relationship and circumstance of the parties. In this way, it ensures a clearer understanding as to the appropriate application of the "reasonable expectations" test.

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[105] For example, whether the conduct is fair.

[106] The Canadian oppression cases reveal a "paucity of principled discussion of the values being served by the protection of the "reasonable expectation": Chapman, *supra*, note 93 at 201.

[107] For example, the vulnerable position of a minority shareholder in a close corporation is well recognized by the courts.

The American courts' recognition of a minority shareholder's vulnerability is apparent in both the common law fiduciary duty cases and the statutory oppression cases. F. Hodge O'Neal has been given credit for some of this recognition in light of the extensive energy he has devoted to the topic of close corporations.[108] In contrast, the Canadian courts focus more on the general notion of fairness rather than on its specific application in the corporate context. There is not as much emphasis or discussion in the Canadian cases on the specific features of a corporate situation that may render certain parties, such as minority shareholders, more vulnerable to exploitation. This suggests that the Canadian courts do not appreciate, to the same degree, the corporate situations that are more likely to give rise to shareholder oppression.

The third way in which the American use of the "reasonable expectations" test is more developed than the Canadian approach is tied to their general judicial approach. The American courts are better adapted to pursuing a "reasonable expectations" type of inquiry in light of their tradition of judicial activism. The courts in the United States have traditionally been more activist in nature than the Canadian courts.[109] They are less precedent bound.[110] Therefore when applying a legal rule, they are more inclined to concentrate on the facts of the particular case and the attendant policy considerations.[111]

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[108] Thompson, *supra*, note 30 at 193. O'Neal has authored and co-authored comprehensive texts on the subject. For example, F. Hodge O'Neal and Robert B. Thompson, *O'Neal's Oppression of Minority Shareholders: Protecting Minority Rights in Squeeze Outs and Other Intracorporate Conflicts*, 2nd ed., vols. 1 & 2 (Deerfield, Ill.: Clark Boardman Callaghan, 1985) and F. Hodge O'Neal and Robert B. Thompson, *O'Neal's Close Corporations*, 3rd. ed., (New York, N.Y.: Clark Boardman Callaghan, 1985, updated to 1997). O'Neal has been described as the "nation's leading authority on close corporations" as early as 1978. For example, see Harry J. Haynsworth, "The Need for a Unified Small Business Legal Structure" (1978) 33 Bus.Law. 849 at 860.

[109] MacIntosh, Holmes & Thompson, *supra*, note 3 at 89.

[110] MacIntosh, Holmes & Thompson, *ibid.*

[111] MacIntosh, Holmes & Thompson, *ibid.* at 92, 95.

This predisposition renders them well equipped to apply the "reasonable expectations" test since the test requires judicial activism. This activism is both in the specific and general sense. Specifically, the test requires the courts to "construct" the underlying agreement by having regard to the circumstances of the case. More generally, the open wording requires the courts to consider the general policy concerns prompting the remedy and apply such concerns to a concrete fact situation. The wording thereby mandates a court to protect vulnerable parties without unduly restricting the legitimate interests of the other corporate participants. This activist tradition is distinct from the precedent based approach which is popular in Canada.[112]

In summary, the American and Canadian use of the "reasonable expectations" test is similar to the extent that neither have comprehensively identified the structure and content of the "reasonable expectations" test. The approach in the United States, however, is more developed in several respects. In these ways, the American experience can help shed light on and guide the application of the "reasonable expectations" test in Canada.

General American literature on corporate law is also insightful due to the prevalence of economic analysis in such literature. Law and economics scholars are devoting increased attention to the subject of close corporations in the United States. It is hoped that this attention will spawn new and improved developments in the area of minority shareholder protection.[113] It is the author's submission that economic analysis can assist in more clearly delineating the structure and content of the oppression remedy's "reasonable expectations" test. The insight that economic analysis can provide to the "reasonable expectations" test is comprehensively reviewed in Chapter Four of this thesis.

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[112] Chapman, *supra*, note 93 at 198-99; MacIntosh, Holmes & Thompson, *ibid.* at 96-99. Chapman notes that at least the Supreme Court of Canada is showing an inclination towards generalized rules and away from an emphasis on precedent. MacIntosh credits the *Charter of Rights and Freedom* contained within the *Constitution Act, 1982* as influencing the Canadian courts to be more policy minded and less precedent bound. He further comments that he expects that this development will spill over into areas beyond public law. See MacIntosh, Holmes & Thompson, *ibid.* at 134.

[113] O'Neal & Thompson, *supra*, note 9 at iv. of 1996 Preface.

CHAPTER FOUR

THE "REASONABLE EXPECTATIONS" TEST AND THE ECONOMIC THEORY OF "INCOMPLETE CONTRACTING"

I. SUMMARY OF THE CONCLUSIONS RELATING TO THE CURRENT APPLICATION OF THE OPPRESSION REMEDY IN CANADA

There is little judicial commentary, even in the recent case law, on the focus of the "reasonable expectations" test and on the principles which should be considered within the confines of this test. The conclusions reached in this thesis are drawn largely from an analysis of the application of the "reasonable expectations" test and a consideration of the surrounding circumstances in each situation. These general principles are based on an analysis of the second stage case law as a whole. Therefore these principles may not be universally adopted in every case.[1] The main conclusions reached thus far relating to the oppression remedy and the current Canadian application of the "reasonable expectations" test are as follows:

(a) The oppression remedy applies to both public and closely held corporations in Canada.[2] It is well recognized that the oppression remedy is a much needed remedy for closely held corporations. One must, however, be careful not to underestimate the need for the oppression remedy in certain types of public corporations. This is particularly the case in Canada where the typical public corporation has a dominant shareholder and illiquid shares. These features enhance the potential for shareholder conflict and exploitation. The courts tend to consider all public corporations to be widely held and highly liquid. Thus they perceive a much more limited role for the oppression remedy when a public corporation is involved. As a result, there is little express judicial recognition of the potential significance the oppression remedy could have on certain types of public corporations.

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[1] It is hoped that drawing attention to these principles will result in a more universal approach to the application of the remedy.

[2] This is a well accepted fact in the oppression cases. See *supra*, Chapter Two, Sections I. and II.C.3.c.iv. for commentary and case law relating to this subject.

(b) A consistent theme found within the oppression cases decided from and including 1991 is the general acceptance of the "reasonable expectations" test, either expressly or by implication, as the basis for ascertaining whether or not to apply the oppression remedy. The "reasonable expectations" test applies to both public and closely held corporations.

(c) In general, the cases do not specifically articulate what is contemplated by the "reasonable expectations" test. An analysis of the cases that apply the test suggests that main focus of the "reasonable expectations" test is to discern the underlying compact or basis of association between or amongst the parties. In order to ascertain the content of the parties' compact, the courts will not be confined to a contractual inquiry, in a contract law sense. The minimal judicial direction in this regard confirms that the inquiry may incorporate what the parties have agreed to, in a broad sense of the term, as well as what they ought to have agreed to.

(d) Certain criteria are particularly important when determining the parties' underlying agreement. There are many other potentially relevant factors, since one must always consider the entire circumstances of the case. The following five criteria, however, figure very prominently in the second stage case law:

i. relevant written documentation;

ii. the business judgment rule and the principles it represents;

iii. the type of conduct insofar as it amounts to an appropriation of corporate assets or opportunities to the detriment of the complainant;

iv. the type of corporation in terms of whether it is a closely held corporation, in which case the minority shareholders are more vulnerable to shareholder exploitation and are more likely to have expectations relating to management and employment involvement; and

v. the foreseeability of the conduct in question.

The foregoing list is not exhaustive. It does help identify, however, important factors to consider and balance when a determination is being made as to whether an expectation is reasonable.

The foregoing conclusions relating to the "reasonable expectations" test confirm that it is a more refined test than the "general fairness" test endorsed by the early Canadian case law. Unfortunately, few of these conclusions are expressly recognized in the oppression case law on a consistent basis. The judiciary's avoidance in this regard leaves the "reasonable expectations" test very bare. Standing alone, the test raises as many questions as it answers.[3] There remains, consequently, a lack of structure or format for the "reasonable expectations" test which could significantly undermine its effectiveness. The test's usefulness will depend on the extent to which its parameters and content are expressly identified by the judiciary.

The formulation of a more comprehensive theoretical framework for the "reasonable expectations" test constitutes the main endeavour of this Chapter Four. The above conclusions could greatly assist in this endeavour to the extent that they become expressly recognized and endorsed by the courts. These conclusions therefore provide essential structure and content to the "reasonable expectations" test. It is hoped that associating the "reasonable expectations" test with the economic theory of "incomplete contracting" will facilitate the judicial recognition and endorsement of these conclusions. Prior to reviewing this economic theory, the next section will consider the oppression remedy's need for both flexibility in the form of judicial discretion, as well as certainty.

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[3] John J. Chapman, "Corporate Oppression: Structuring Judicial Discretion" (1996) 18 Adv. Q. 170 at 189.

II. THE NEED FOR BOTH DISCRETION AND CERTAINTY

One of the conclusions drawn from an analysis of the Canadian oppression case law is that the "reasonable expectations" test mandates a court to consider the true compact amongst the parties to determine the reasonableness of an expectation. Another important conclusion is that an open list of potentially relevant factors is to assist in the determination of the underlying agreement. Depending on the circumstances, any factor may or may not be relevant. This reality reinforces the uncertainty associated with the remedy and supports the often repeated judicial statement that each case turns on its own facts. The precedent value of a particular case may accordingly be negligible to the extent that it does not involve identical facts since a slightly different factual setting may have a pivotal impact on whether the remedy will apply.[4] The courts have been inclined to steer away from setting specific rules to guide the oppression remedy's application.[5] The judiciary's continued reluctance to extrapolate on the focus of the "reasonable expectations" test, and on the pivotal principles to balance within the confines of the test, further exacerbates the uncertainty already associated with such a broadly worded remedy.

The absence of express judicial comment when determining the "reasonable expectations" test will inevitably result in the improper application of the oppression remedy. This is because the courts will not know what principles to assess when faced with a "reasonable expectations" inquiry. The judicial discretion required by both the broadly worded oppression remedy and its "reasonable expectations" test necessarily means that some certainty will be sacrificed in order for the remedy to meet its objective.[6] Discretion and certainty, however, are not mutually exclusive concepts. It is not only possible, but also desirable, particularly in the case of the oppression remedy, for both to co-exist. It then becomes a matter of assessing the optimum balance.

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[4] As noted in *Ferguson* v. *Imax Systems Corp.* (1983), 43 O.R. (2d) 128 at 137, 150 D.L.R. (3d) 718 (C.A.), rev'g 134 D.L.R. (3d) 519, 38 O.R. (2d) 59, 28 C.P.C. 290 (rev'g 12 B.L.R. 209), leave to appeal refused 52 N.R. 317*n*, 2 O.A.C. 158*n*., "what is oppressive or unfairly prejudicial in one case may not necessarily be so in the slightly different setting of another." This statement was adopted in many subsequent cases. For example, see *supra*, Chapter Two, note 155 and accompanying text.

[5] Chapman, *supra*, note 3 at 184-89.

The oppression remedy's need for judicial discretion is obvious.[7] The enabling, as opposed to regulatory, nature of corporate legislation[8] means the number of corporations with different characteristics is potentially limitless. Corporations may differ from each other in many respects including having different share structures, governance structures[9] and profit distribution methods.[10] Equally limitless are the number of times a corporation may opt to change these characteristics during the course of its existence.

An effective remedy would have to account for all of these potential situations. A particular course of conduct may warrant application of the remedy in one situation, but not in another, depending on the circumstances of a particular case.[11] If the wording of the oppression remedy or the "reasonable expectations" test was too specific, it may miss the myriad of circumstances that would properly give rise to the application of the remedy. At the same time, it may improperly condemn conduct that should otherwise not fall within the remedy's purview.[12] The only viable alternative is to have a broadly worded remedy and overriding test which set a particular standard of conduct.[13] This helps to ensure that the need for the oppression remedy and its legislative intent are clearly understood.

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[6] John A. Campion, Stephanie A. Brown and Alistair M. Crawley, "The Oppression Remedy: Reasonable Expectations of Shareholders" [1995] L.S.U.C. Special Lectures 229 at 253.

[7] *Ibid.* at 233.

[8] See *supra,* Chapter One, note 67 and accompanying text. It follows the American corporate precedent in this regard. See Frank H. Easterbrook and Daniel R. Fischel, "The Corporate Contract" [1989] Colum. L. Rev. 1416 at 1416-1418. They specifically note (at 1417) that "the corporate code in almost every state is an 'enabling' statute." See also Larry E. Ribstein, "Efficiency, Regulation and Competition: A Comment on Easterbrook and Fischel's *Economic Structure of Corporate Law*" (1992) 87 Nw.U.L.Rev. 254 at 254.

[9] Charles R. O'Kelley, Jr. "Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis" (1992) 87 Nw.U.L.Rev. 216 at 253.

[10] Easterbrook & Fischel, *supra*, note 8 at 1426-27.

Having recognized the need for flexibility in the sense of judicial discretion, one must now have regard to the benefits gained by certainty. The potentially broad ambit of the oppression remedy mandates the determination of its parameters. Greater certainty leads to greater consistency in the remedy's application. Consistency enhances the predictability of the outcome because the remedy's ambit will be more readily identifiable. It also reduces the likelihood of "indeterminate and arbitrary exercises of judicial power."[14] The increased direction guides the judiciary, lawyers and business persons as to the type of conduct that may run afoul of the oppression remedy.[15] It should help prevent wrongful conduct from occurring in the first place, to the extent that an inquiry is made prior to a course of action being taken. Even where the conduct has already occurred, greater certainty will often increase out of court settlements to the extent that it makes a particular outcome more obvious. Both results would serve to reduce the caseload in the courts.[16]

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[11] See *supra*, note 2.

[12] See the following comment by Hetherington & Dooley:

> Given the limitations of human foresight and knowledge, any attempt to describe the majority's duties and obligations precisely is likely to leave the minority vulnerable to some overlooked form of exploitation, while at the same time, seriously impairing the efficiency of the firm by fettering management: J.A.C. Hetherington & Michael P. Dooley, "Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem" (1977) 63 Va. L. Rev. 1 at 37.

Although this comment was to explain why it is unrealistic to expect that the shareholders' respective rights and interests will be fully set out in writing, it also helps explain why both the oppression remedy and the "reasonable expectations" test need to be broadly worded.

[13] The remedy must have a certain amount of flexibility (discretion), to ensure its goal of fairness is accomplished: Chapman, *supra*, note 3 at 177.

As well, a clearer definition of the remedy's ambit better allows one to analyse the appropriateness of the ambit. The oppression remedy's importance accentuates the need for continual analysis in this regard. To the extent that there is a significant erosion of certainty, the advantages described above will be lost. In addition, public disdain for the legal system will inevitably increase, especially when the oppression remedy is so broadly worded.

In recognition of the foregoing, the application of the oppression remedy must allow for judicial discretion without completely sacrificing certainty. To date, the judicial comment in respect of the oppression remedy has generally emphasized flexibility and judicial discretion.[17] At the outset, a less confined approach was not only understandable, it was also likely optimal.[18] The judiciary was thereby given a chance to consider the wording of the remedy and the historical backdrop prompting the remedy. It also exposed the judiciary to the numerous circumstances in respect of which an oppression claim may arise. Adequate exposure decreases the likelihood that the courts will choose arbitrary rules which confine the remedy's application to inappropriate situations.

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[14] Campion, Brown & Crawley, *supra*, note 6 at 233.

[15] The lack of expertise of Canadian courts in corporate matters enhances the need for some certainty: Brian R. Cheffins, "An Economic Analysis of the Oppression Remedy: Working Towards a More Coherent Structure of Corporate Law" (1990) 40 U.T.L.J. 775 at 790.

[16] See Chapman, *supra*, note 3 at 184 who feels that the uncertainty associated with the early oppression cases likely led to a "proliferation of lengthy and expensive litigation." This concern is particularly important given the typically litigious nature of a shareholder: Christopher A. Riley, "Contracting Out of Company Law: Section 459 of the *Companies Act* 1985 and the Role of the Courts" (1992) 55 M.L.R. 782 at 785.

[17] Chapman, *ibid.* at 184-89.

The courts, however, have had sufficient time and exposure. It is now appropriate for the courts to provide more concrete guidance for the application of the remedy. The judiciary must focus more intently on enhancing the certainty of the oppression remedy's application. The widespread adoption of the "reasonable expectations" test amounts to an appropriate first step and supports the judiciary's recognition of the need for greater certainty.[19] The courts, however, must go further. The judiciary must clearly outline the focus of the test and more specifically address the important principles to apply within the confines of the "reasonable expectations" test. This is not to say that the court should subscribe to a host of specific rules which could run contrary to the remedy's objective. Rather, the courts could simply state the focus of the test as well as the general principles or considerations being balanced when making the determination as to whether an expectation is reasonable.

The conclusions summarized *supra*, in Section I. of this Chapter Four represent the basic components of the "reasonable expectations" test. These conclusions were gleaned from a case law review of its application in oppression cases. The judiciary must be encouraged to expressly recognize these conclusions. This will not only enhance the certainty of the test but also the consistency in its application. It should also more readily lead to the development of these and additional principles to further guide the application of the "reasonable expectations" test. The optimum method to incline the judiciary in this regard is to make the conclusions more coherent and cohesive. The development of a clearly discernable structure for the "reasonable expectations" test based on these conclusions should assist in this regard.

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[18] This is in light of the common law history which gave rise to the enactment of the statutory oppression remedy. As well, some authors recognize that a lack of specific application guidelines is common in the early stages of the development of a new legal doctrine. For example, see Kenneth S. Abraham, "Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured" (1981) 67 Va. L. Rev. 1151 at 1197; Donald F. Clifford, Jr. "Close Corporation Shareholder Reasonable Expectations: The Larger Context" (1987), 22 Wake Forest L.R. 41 at 41.

[19] Campion, Brown & Crawley, *supra*, note 6 at 253.

A central purpose of this Chapter Four is to develop a more concrete theoretical framework for the "reasonable expectations" test. The intent is to make the "reasonable expectations" test a better conceptual apparatus through which one can examine and assess the application of the oppression remedy. The author submits that the economic theory of "incomplete contracting" can aid in this endeavour by lending some methodology to the "reasonable expectations" test. An appreciation of this economic theory will provide insight into a more structured application for the "reasonable expectations" test. In this way, the "incomplete contracting" theory can assist in the development of a theoretical framework for the "reasonable expectations" test and thereby facilitate a better appreciation of the structure and content of the "reasonable expectations" test.

III. ECONOMIC ANALYSIS

A. General

The economic concept of "incomplete contracting" is rooted in economic theory. Economic analysis of the law covers an extremely broad area, thereby preventing a detailed appraisal of it within the confines of this thesis. It is important, however, to review some of its general assumptions and principles, insofar as they are applicable to corporate law. This review will provide additional insight into the "incomplete contracting" theory which is still in its developmental stages in terms of its applicability to corporate law.[20]

The economic approach to corporations which has grown tremendously over the last few decades, and is the one upon which the "incomplete contracting" theory is premised, is the contractarian view of the corporation.[21] A primary force behind the contractarian movement was the characterization of the corporation as a "nexus of contracts."[22] That is, that corporations represent a complex web of agreements, both implicit and explicit, amongst and between the various participants in a corporation.[23] A shareholder would be

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[20] See *infra*, note 40 and accompanying text.

[21] Cheffins, *supra*, note 15 at 784, 795; William W. Bratton, "The Economic Structure of the Post-Contractual Corporation" (1992) 87 Nw.U.L.Rev. 180 at 181. Easterbrook and Fischel have been regarded as the leading advocates of the contractarian movement: Bratton, *supra*, at 180-183.

[22] Bratton, *ibid.* at 184. Jensen and Meckling coined the term "nexus of contracts." See Michael Jensen and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 J. Fin. Econ. 305 at 311. Advocates of the contractual basis of corporate law include Easterbrook, Fischel, Macey & VanDuzer. As Chapman notes in his book review of Easterbrook and Fischel's *The Economic Structure of Corporate Law*, "for Easterbrook and Fischel the 'engine' that drives corporate law is contract": Bruce Chapman, "Book Review on *The Economic Structure of Corporate Law*" (1994) 23 Can. Bus. Law J. 145 at 146.

[23] Easterbrook & Fischel, *supra*, note 8 at 1426-28. The contractual underpinnings to the economic notion of "incomplete contracting" enhance the ease of associating it with the oppression remedy's "reasonable expectations" test. The test's focus is on the underlying agreement amongst the parties: Cheffins, *supra*, note 15 at 783-784. The "reasonable expectations" inquiry is not entirely "contractual," in the strict legal sense, yet it has contractual undertones. Also, contractual law is often thought of as the area of law closest to corporate law. As noted by Chapman, "both deal with the voluntary ordering of commercial relations": Chapman, *supra*, note 3 at 174 n. 13. The realization of the contracting parties' reasonable expectations has long been considered the essence of contract law: Clifford, Jr. *supra*, note 18 at 42; Chapman, *supra*, note 3 at 188.

While the traditional method of contract enforcement differs significantly from that found one such participant and is therefore merely one of a number of contracting parties.[24] The different types of corporate agreements that could arise are "wonderfully diverse, matching the diversity of economic activity that is carried on within corporations."[25]

Mainstream contractarians have now tempered the "nexus of contracts" approach in recognition of the fact that, in some cases, contracts will fail.[26] The realization that contracts are not the sole answer opens the door for corporate governance rules and potentially, government regulation.[27] It is therefore recognized that while corporate law has "significant contractual aspects," it is not solely a "nexus of contracts."[28] Instead, relational aspects must factor into the model.[29]

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with respect to the oppression remedy, recently adopted performance standards in contract law, such as the duty of good faith and fair dealing, reflect a trend towards importing a duty of fairness which is consistent with corporate law. These new duties in contract law have made inroads on the strict application of traditional contract principles: Chapman, *supra*, note 3 at 188; Clifford, Jr. *supra*, note 18 at 43, 46-48 (although Clifford. Jr. is speaking about American law, the same is true in Canada). See also Justice Beverley M. McLachlin, "A New Morality in Business Law?" (1990) 16 Can. Bus. Law J. 319 wherein she recognizes the trend towards fairness in corporate law.

[24] Cheffins, *supra*, note 15 at 795-96. Shareholders are not viewed as owners but rather as investors or suppliers of equity capital: Jonathan R. Macey, "An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties" (1992) 21 Stetson L. Rev. 23 at 27 n. 5 and accompanying text.

[25] Easterbrook & Fischel, *supra*, note 8 at 1426.

[26] Bratton, *supra*, note 21 at 183-84. Some of the reasons for contractual failure include opportunistic behavior and "intrinsic limits on the problem solving abilities of contracting parties": Bratton, *supra*, note 21 at 184. See also Cheffins, *supra*, note 15 at 785-86 who outlines several reasons why a court cannot simply rely on written agreements.

[27] Bratton, *ibid.* at 184.

[28] Bratton, *ibid.*

[29] Bratton, *ibid.* at 185.

From an economic perspective, the central motivation for establishing a firm, of which corporations are a subset,[30] is the determination that the resulting contracts will be more efficient than if one were left to contract in the open market.[31] Corporate law serves to help minimize the cost of associating by highlighting areas which should be negotiated and by providing background or standard terms that the parties would otherwise have had to expressly adopt.[32]

Economic analysis is gaining in prominence in corporate law theory in the United States, England and Canada.[33] Yet, somewhat ironically, in one sense, the idea that the corporation is comprised of contracts is more consistent with the memorandum and articles of association legislation which was formerly popular in Canada.[34] Pursuant to the corporate law reforms commencing in the 1970s, many jurisdictions in Canada opted for the corporate form commonly used in the United States.[35] Corporate statutes which incorporate this American form can be found in most of the legal jurisdictions in Canada.[36]

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[30] Richard A. Posner, *Economic Analysis of Law*, 4th ed. (Boston: Little, Brown and Company, 1992) at 392; Easterbrook & Fischel, *supra*, note 8 at 1425.

[31] Easterbrook & Fischel, *supra*, note 8 at 1422-23. See also Oliver Hart and John Moore, "Property Rights and the Nature of the Firm" (1990) 98 J. of Pol. Econ. 1119 at 1120.

[32] Cheffins, *supra*, note 15 at 786; Posner, *supra*, note 30 at 396; D.D. Prentice, "The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the *Companies Act* 1985" (1988) 8 Oxford J. of Legal Studies 55 at 59. Fischel and Easterbrook describe the background terms as supplementary rules that apply unless the parties contract around them: Easterbrook & Fischel, *ibid.* at 1444-46.

[33] J. Anthony VanDuzer, "Who May Claim Relief From Oppression: The Complainant in Canadian Corporate Law" (1993) 25 Ottawa L.R. 463 at 479. Cheffins notes that some view it as the "single most important theoretical approach to corporate law": Cheffins, *ibid.* at 775. See also Cheffins, *ibid.* at 783 and Bratton, *supra*, note 21 at 197, who comments that by 1988, "economic analysis had become everyday business." Justice Beverley M. McLachlin also recognized this growth and further commented that:

> The same years that have seen a trend towards appealing to fairness have also seen the growth and acceptance of the Law and Economics school of legal analysis: McLachlin, *supra*, note 23 at 323.

The growth in England is evidenced by the recent English literature on the subject. For example, see Riley, *supra*, note 16 and Prentice, *ibid.*

Therefore the corporate form currently popular in Canada does not have a provision deeming it to be contractual in nature. This does not preclude contractually based economic theory from being relevant to corporate law.[37] It does, however, help illustrate why one should exercise some caution before endorsing a whole-hearted application of economic theory to corporate law.[38] As well, economic theory on the law comprises a large and diverse area, with many attendant assumptions and principles. There is also not always complete agreement amongst the law and economics analysts as to what principles should fall within the confines of a particular economic theory.[39] Consequently, when supporting an economic theory for the legal realm, one must be careful to identify the particular economic principles and assumptions which are being endorsed. This avoids unknown and potentially inapplicable assumptions from being erroneously included. It is this approach that is being adopted herein.

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[34] Cheffins, *ibid.* at 784 n. 37. This is because the memorandum of association and articles of association, which formed the basis of a company's existence, were deemed to constitute a contract amongst the members of the company and the company. See also Bruce L. Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Toronto: Butterworths, 1991) at 548. This company structure represents the form currently popular in England.

[35] Brian Cheffins, "The Oppression Remedy in Corporate Law: The Canadian Experience" (1988), 10 U.Pa.J. Int. Bus. L. 305 at 307. This type of corporate form utilizes the articles of incorporation and bylaws structure as the framework for a corporation's constitution. Corporate existence is based on a simple registration procedure. For more information on the corporate history in Canada, see Jeffrey G. MacIntosh with Janet Holmes and Steve Thompson, "The Puzzle of Shareholder Fiduciary Duties" (1991) 19 Can. Bus. Law J. 86 at 105-112. In light of the *CBCA*'s difference in this regard from the memorandum and articles of association statutes, Welling argues against a contractual analysis of the *CBCA* or any cognate statutes. See Welling, *ibid.* at 548 n. 285.

[36] Exceptions include the provinces of British Columbia and Nova Scotia.

[37] See *infra*, Section III.C.6.b. of this Chapter Four, for a list of reasons why this difference is not too important.

[38] Cheffins, *supra*, note 15 at 788.

B. The Economic Concept of "Incomplete Contracting"

The economic theory of "incomplete contracting" is still developing in many respects.[40] There is, however, consensus in the literature on certain elements of this theory even though its exact content and confines may not be universally agreed upon. In light of the varying opinions on certain aspects of this theory, it is important to focus on the specific tenets referred to herein. The theory of "incomplete contracting" will continue to develop as its application potential becomes more fully realized.

The economic theory of "incomplete contracting" is not new to economic analysis.[41] Contracts and contract law have been, and remain, a major focus for this concept.[42] In recent years, increased attention is being paid to its potential application in the corporate law context.[43] This is in response to the growing recognition that many intra corporate contracts are rarely fully articulated in writing.[44] Accordingly, it directly challenges any assumption that the corporate structure represents a complete contracting situation.[45] The incomplete contracting theory is still developing in terms of its application to different aspects of corporate law.[46]

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[39] This is not necessarily unique to economic theory as it is endemic to many theoretical pursuits.

[40] Ian Ayres and Robert Gertner, "Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules" (1992) 101 Yale L. J. 729 at 729.

[41] Ayres & Gertner, *ibid.* at 729.

[42] For example, see Subha Narasimhan, "Of Expectations, Incomplete Contracting, and the Bargain Principle" (1986) 74 Cal. Law Rev. 1123 and Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracts* (New York: The Free Press, 1985).

The theory of "incomplete contracting," as its name suggests, recognizes the potential, and sometimes inevitable, incompleteness of many written contracts.[47] A contract is incomplete if it does not set out the parties' obligations for a particular event. It may also be considered incomplete if it addresses the parties' obligations, but does not adjust their obligations in accordance with the numerous circumstances within which an event may arise. Therefore the parties' obligations may be fully set out in the contract, yet it may be construed as having gaps because it is not specific enough. This latter type of incompleteness is sometimes referred to as being "insufficiently state contingent."[48]

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[43] Oliver Hart, "An Economist's View of Fiduciary Duty" (1993) 43 U.T.L.J. 299 at 299. 313; B. Chapman, *supra*, note 22 at 145; Lewis A. Kornhauser, "The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel" (1989) Colum. L. Rev. 1449 at 1449.

[44] Cheffins, *supra*, note 15 at 785; Riley, *supra*, note 16 at 786; VanDuzer, *supra*, note 33 at 479; O'Kelley, Jr. *supra*, note 9 at 216. Aghion and Bolton argue that financial contracts between or amongst parties within a firm are inherently incomplete: Philippe Aghion and Patrick Bolton, "An Incomplete Contracts Approach to Financial Contracting" (1992) 59 Rev. of Econ. Studies 473 at 473.

[45] A complete contracting situation generally means a situation where the full range of possible commitments and obligations of all parties have been identified and set forth in writing: Gillian K. Hadfield, "An Incomplete Contracting Perspective on Fiduciary Duty" (1997) 28 Can. Bus. Law J. 141 at 142.

[46] Hart, *supra*, note 43 at 301-302, 313.

[47] Although, as is noted *infra*, the inquiry is not entirely contractually driven. A distinction is sometimes drawn between whether the contract is incomplete in an obligation sense as opposed to being contingently incomplete. The former being associated with legal scholars and the latter with economic scholars. See Ayres & Gertner, *supra*, note 40 at 730-31. For the purposes of this thesis, no such distinction will be made.

The "incomplete contracting" theory recognizes several reasons why contracts are incomplete. For the purposes of this thesis, the emphasis will be on those which are more likely to arise in the corporate realm. Several of the reasons why intra corporate contracts may be incomplete are as follows:[49]

(a) Transaction costs, such as time and monetary expense, associated with identifying, bargaining and then committing to writing all aspects of a contractual relationship will generally be prohibitive.[50]

(b) Communication problems may result in the agreement not being an accurate representation of the arrangement as where an agreement uses vague or ambiguous language.[51] In certain situations, these communication problems may result from an attempt to minimize the transaction costs.

(c) The parties' inability to anticipate all possible contingencies, due to lack of foresight, emphasizes the extreme difficulty of achieving a "complete" contract.[52] In such cases, the parties are generally unable to fully allocate their respective obligations. This factor affects the rationality of a parties' decisions.[53] A party may not always act rationally due to the numerous variables that must be considered in each case.[54] Alternatively, the parties may anticipate the contingency, yet they may have deferred negotiation on it due to its complexity or uncertainty.[55]

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[48] Ayres & Gertner, *ibid.* A definition of "incompleteness" which includes both of the above types casts a wide net. Some theorists argue that every contract is incomplete. For example, see Williamson, *supra*, note 42 at 164, 178. These theorists are generally viewing completeness in terms of whether it is sufficiently state contingent: Ayres & Gertner, *ibid.* at 731 n. 10.

[49] Cheffins, *supra*, note 15 at 785-86.

[50] Hart, *supra*, note 43 at 300; Easterbrook & Fischel, *supra*, note 8 at 1433; Hadfield, *supra*, note 45 at 150; Riley, *supra*, note 16 at 786; Ian Ayres and Robert Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules" (1989) 99 Yale L.J. 87 at 92-93; Gillian Hadfield, "Weighing the Value of Vagueness: An Economic Perspective on Precision in the Law" (1994) 82 Calif. L. Rev. 541 at 547-48.

[51] Easterbrook & Fischel, *ibid.*

Where the contracting relationship persists over a long time period, it is more likely for the contingencies to be unknown, uncertain or too complex for appropriate delineation.[56] Insufficient information in these situations helps justify why a written contract may not include a term, as well as why a contractual term may not be upheld by a court.

(d) There may be strategic reasons for a particular gap.[57] One party may be more vulnerable to another party which may lead the latter party to exploit this vulnerability.[58] Unequal access to pertinent information may contribute to a party's vulnerability. For example, one party may know an event is likely to occur, which event will be to the detriment of the other. If the other does not have this knowledge, it is likely it will not contract for protection in this regard. As well, a written contract may expressly address a situation. If, however, the relevant terms authorize opportunistic conduct, then the terms may be held to be invalid which gives rise to a gap in the contract.

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[52] Easterbrook & Fischel, *ibid.* at 1433; Riley, *supra*, note 16 at 786; Ayres & Gertner, *supra*, note 50 at 94 n. 34.

[53] Riley, *ibid.* at 789.

[54] O'Kelley, Jr. *supra*, note 9 at 221. O'Kelley referred to this as "bounded rationality."

[55] Hadfield, *supra*, note 50 at 547-48.

[56] VanDuzer, *supra*, note 33 at 480.

[57] Hadfield, *supra*, note 50 at 550.

[58] Hadfield, and others, refer to this as strategic behavior: Hadfield, *supra*, note 45 at 150; Ayres & Gertner, *supra*, note 50 at 92, 94.

It is easy to foresee many situations where any one or more of these reasons will prevent parties from expressly articulating all of their interests and expectations in writing. These reasons also help explain why written terms in a corporate contract may not always be enforced by the courts.[59] In such circumstances, the goal of the "incomplete contracting" analyst is to construct the "complete" contract by determining what terms should fill in these gaps. There are differing opinions on the optimum approach to filling in these gaps. Only two approaches will be canvassed herein.[60]

The first of the two approaches to gap filling reviewed herein ascertains what the parties would have agreed to in a given circumstance, if there were full information and no transaction costs.[61] This approach is sometimes referred to as the "hypothetical contract"[62] or the "would have wanted" approach.[63] It relies on the assumption that the parties to an agreement are rational wealth maximizers such that parties would choose terms that maximize their joint wealth.[64] This assumption guides the inquiry. The incentive motivating the determination of the complete agreement is that a complete bargaining situation[65] will result in an allocatively efficient use of resources[66] because it achieves the maximum joint return for all.[67]

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[59] For example, the contract may not accurately reflect the parties' agreement because of transaction costs, communication problems or inadequate foresight. Alternatively, it may be the product of exploitive or opportunistic conduct.

[60] See O'Kelley, Jr. *supra*, note 9 and Ribstein, *supra*, note 8 for additional approaches to gap filling.

[61] VanDuzer, *supra*, note 33 at 480-81; Cheffins, *supra*, note 15 at 792; Easterbrook & Fischel, *supra*, note 8 at 1433. But see Ian Ayres, "Making a Difference: The Contractual Contributions of Easterbrook and Fischel" (1992) 59 U. of Chicago L. Rev. 1391 at 1398-1400 where Ayres suggests that Easterbrook and Fischel have also, at least implicitly, endorsed the use of penalty defaults in some circumstances. See *infra*, notes 72-75 and accompanying text for more information on penalty defaults.

[62] Ayres & Gertner, *supra*, note 40 at 733.

[63] O'Kelley, Jr. *supra*, note 9 starting at 217.

A major criticism of the "hypothetical contract" approach is that it is indeterminate.[68] It is difficult to ascertain what the parties would have agreed to in a given circumstance had there been full information and no transaction costs. Some economic theorists argue that reference should be made to the written contracts of other corporations to determine what the parties would have wanted.[69] Others disagree on the basis that it incorrectly assumes all corporations have similar governance needs[70] and intra corporate shareholder arrangements.

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[64] That is, they will only enter bargains that make them better off: VanDuzer, *supra*, note 33 at 479. See Kornhauser, *supra*, note 43 for a critique of this assumption.

[65] A complete bargaining situation is a situation where there is full information, no transaction costs and the parties have determined their respective obligations for every possible contingency.

[66] The efficiency standard being used is Pareto efficiency which essentially means "trades that make at least one person better off and no one worse off": Gillian K. Hadfield, "The Second Wave of Law and Economics" (1996) 46 U.T.L.J. 181 at 191.

[67] Easterbrook & Fischel, *supra*, note 8 at 1433; Hadfield, *supra*, note 45 at 142. To the extent that the contract is not complete, parties will be motivated to act in a self-interested manner which will often detract from the maximum joint return to be gained from the venture. Consequently, one must discern the complete agreement prior to enforcement. See Hadfield, *supra*, note 45 at 142. The hypothetical contract approach advocated by Easterbrook and Fischel is not without criticism. For example, Kornhauser criticizes the fundamental economic assumption that the terms which maximize joint wealth will be equivalent to the terms the parties would have chosen with full information: Kornhauser, *supra*, note 43 at 1452. See also Ayres & Gertner, *supra*, note 50.

[68] O'Kelley, Jr. *supra*, note 9 at 219 n. 17; Ribstein, *supra*, note 8 at 259.

[69] Easterbrook and Fischel are two advocates of this proposition: O'Kelley, Jr. *ibid.* at 218 n. 14; Ribstein, *ibid.*

The second approach to gap filling herein reviewed incorporates, in part, the "hypothetical contract" standard. It accepts that this standard may be efficient in some, but not all, situations.[71] This approach finds that in some cases, it may be more efficient to impose "penalty" terms.[72] Penalty terms are terms that the parties would not normally have agreed to. These penalty gap fillers, which are sometimes called penalty defaults, are often appropriate where one party is strategically withholding information. More specifically, it would apply to those situations where the parties have asymmetrical information thereby rendering one party vulnerable to opportunistic conduct by another.[73] The penalty default will then often represent what "the informed party does not want."[74] The intent behind penalty defaults is to promote the divulging of information.[75] The imposition of penalty terms diverges from a contractual assessment to the extent that it is not concerned with what the parties have, or would have, agreed to. Instead, the courts impose what the parties *should* have agreed to. Penalty gap fillers allow the courts to intervene and control the resulting relationship so as to minimize the likelihood that one party will take strategic advantage of another more vulnerable party.

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[70] O'Kelley, Jr. *ibid.* at 218 n. 14, 251-52; Ribstein, *ibid.*

[71] Ayres & Gertner, *supra*, note 50 at 91-93. Ayres and Gertner are discussing the "hypothetical bargain" and "penalty gap fillers" in the context of ascertaining how corporate default legislation should be determined. They expressly note, at 129, that their analysis is "quite general and can be applied to a wide range of legal issues." Hadfield follows Ayres and Gertner's approach and has applied it to an analysis of fiduciary duties. Hadfield argues that in situations where transaction costs preclude the express adoption of a fiduciary duty, the fiduciary obligation will represent what the parties would have agreed to. In circumstances where strategic reasons are responsible for the omission, the imposition of a fiduciary obligation will represent a penalty default: see Hadfield, *supra*, note 45 at 149, 150.

[72] Ayres & Gertner, *ibid.*

[73] Ayres & Gertner, *supra*, note 40 at 735.

[74] Ayres & Gertner, *supra*, note 50 at 106.

[75] Ayres & Gertner, *ibid.* at 91, 97. These penalty gap fillers are also sometimes referred to in the literature as "information revealing" terms or "information forcing" terms. See Ayres & Gertner, *supra*, note 40 at 735 n. 24.

Proponents of this second approach to gap filling therefore suggest that one should have regard to the reason for the gap when choosing whether to impose a penalty term or a "would have wanted" (hypothetical contract) standard.[76] The penalty method is often recommended when the reason for the gap is strategically motivated to exploit the vulnerability of another party.[77] The "would have wanted" method is considered more appropriate when transaction costs constitute the reason for the gap.[78]

The second approach to gap filling also recognizes that, in some situations, the particular gap filler or default rule will be the same regardless of whether one relies on the penalty method or the hypothetical contract method. An example of this type of gap filler is the fiduciary duty.[79] This default rule operates to supply a term desired by the parties when transaction costs would otherwise prevent it.[80] The same default rule also acts as a penalty clause where strategic behavior causes the disadvantaged party to either not appreciate the need for, or not be able to obtain, this type of contractual protection.[81]

The second approach to gap filling reviewed herein more appropriately reflects the current approach, by the Canadian judiciary, to the application of the "reasonable expectations" test.[82] This gap filling approach is not only concerned with what the parties *would* have agreed to (ie. the hypothetical gap filler). It also, in some cases, applies what the parties *should* have agreed to (ie. the penalty gap filler).

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[76] Hadfield, *supra*, note 45 at 150; Ayres & Gertner, *ibid.* at 92-94.

[77] Hadfield, *ibid.* at 149-50; Ayres & Gertner, *ibid.* at 93.

[78] Hadfield, *ibid.*; Ayres & Gertner, *ibid.* at 93.

[79] Hadfield, *ibid.*

[80] Hadfield, *ibid.* at 150.

[81] Hadfield, *ibid.*

C. Use of "Incomplete Contracting" Principles to Help Structure the "Reasonable Expectations" Test

1. General

The overriding advantage to be gained from the association of the "incomplete contracting" theory with the oppression remedy's "reasonable expectations" test is the development of a more discernable and comprehensive structure for the "reasonable expectations" test. There are certain features of the "incomplete contracting" theory that resemble the Canadian application of the "reasonable expectations" test. Drawing attention to these common attributes will assist in the development of the test's structure and thereby give rise to a more clearly identifiable "reasonable expectations" test. It is hoped that an appreciation of the "incomplete contracting" theory will provide a more structured application to the "reasonable expectations" test.[83]

Commentary relating to the economic analysis of corporate law and the economic theory of "incomplete contracting" derives largely, although not solely, from the American literature.[84] There is only minimal express commentary associating contractual economic theory with the oppression remedy's "reasonable expectations" test.[85] Several authors, however, have incorporated certain aspects of the "incomplete contracting" theory into their analyses of the oppression remedy.[86] As well, the "incomplete contracting" theory has been relied upon to help explain the fiduciary duty owed by corporate management to

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[82] See *infra*, Section III.C.4. of this Chapter Four for a further discussion of this subject.

[83] Certain aspects of the "incomplete contracting" theory may not be applicable to, or appropriate for, the "reasonable expectations" test. It is only those features referenced herein that the author feels are most relevant to developing a framework for the oppression remedy's "reasonable expectations" test.

[84] Cheffins, *supra*, note 15 at 783. Economists are not the only ones to recognize the potential for incomplete contracts. Legal theorists have also recognized this reality, particularly in the area of relational contracts: Charles J. Goetz and Robert E. Scott,

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"Principles of Relational Contracts" (1981) 67 Va. L. Rev. 1089 at 1089-91; Gillian Hadfield, "Judicial Competence and the Interpretation of Incomplete Contracts" (1994) 23 J. Legal Stud. 159 at 159-60. Hadfield feels, however, that a typical lawyer's conception of incompleteness may not be as broad as that of an economist. But see Alan Schwartz, "Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies" (1992) 21 J. Legal Stud. 271 at 278 where he draws attention to certain similarities between law and economics theorists and legal relational theorists with respect to incomplete contracts.

[85] Cheffins comments that the "expectations" approach resembles, in several respects, a contractual economic approach to corporate law: Cheffins, *ibid.* at 783. See also VanDuzer, *supra*, note 33 at 481, where he states that the "reasonable expectations" approach is consistent with what a contractual "economic approach would recommend." He does not, however, discuss this issue in much detail.

[86] Cheffins, *ibid.* generally; Riley, *supra*, note 16 at 786; Prentice, *supra*, note 32. Although Cheffins does not expressly reference the "incomplete contracting" theory, the economic principles he supports represent several core elements of this theory. He emphasizes the insight that can be gained by applying economic analysis to the oppression remedy. See also Brian R. Cheffins, *Company Law: Theory, Structure and Operation*, (Oxford: Clarendon Press, 1997) at 471 wherein he views the oppression remedy itself as being gap-filling in nature. Riley uses an "incomplete contracting" analysis when considering the English oppression remedy. It should be noted that although the *Companies Act* (U.K.), 1985, c. 6 "expressly endows the relationship between shareholders, and between shareholders and their company, with contractual status" [Riley, *supra*, note 16 at 784], this does not render Riley's comments inapplicable in the Canadian corporate environment in light of the many other similarities. See also *infra*, Section III.C.6.b. of this Chapter Four which discusses why the absence of this legislative provision does not preclude the applicability of contractual economic analysis. Prentice uses general economic theory to discuss the English oppression remedy. He does not use the term "incomplete contracting" yet he does recognize that the typical inter-shareholder contract will not be completely expressed in writing. The courts must then fill in the gaps.

shareholders[87] and long-term intra corporate financial contracts.[88]

There is also support for a contractual approach to the application of the fiduciary duty owed, in the United States, by controlling shareholders to minority shareholders.[89] This contractual approach incorporated a "reasonable expectations" analysis. The "incomplete contracting" theory was not specifically referred to since the main focus was on the "reasonable expectations" approach. The contractual principles discussed were, however, suggestive of the "incomplete contracting" theory. The scholar's ease in associating the "reasonable expectations" test with a contractual analysis is worthy of note.

The "incomplete contracting" theory has also been used in association with relational contracts.[90] Many intra corporate contracts, which are the main focus of the "reasonable expectations" test, could be viewed as relational contracts, particularly where the corporation is closely held.[91] A relational contract is one in which "the parties are incapable of reducing important terms of the arrangement to well-defined objectives."[92] Relational contracts generally involve continuing relationships and are commonly viewed as having two main features: incompleteness and longevity.[93] The incompleteness stems largely from the complexity and uncertainty associated with a contracting situation that persists over a long period of time. In such circumstances, there are many unknown contingencies and it is difficult to precisely articulate the respective obligations of each party. These features accurately describe a typical shareholder situation, particularly if the corporation is closely held.

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[87] Macey, *supra*, note 24 at 25, 43-44; Hart, *supra*, note 43 at 301; Hadfield, *supra*, note 45 at 141-45.

[88] Aghion & Bolton, *supra*, note 44.

[89] J.A.C. Hetherington, "Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities" (1987) 22 Wake For. L.R. 9. This American fiduciary duty doctrine is viewed as being somewhat interchangeable with, although not identical to, the statutory oppression remedy. See generally Robert B. Thompson, "The Shareholder's Cause of Action For Oppression" (1993) 48 The Bus. Lawyer 699 and *supra*, Chapter Three, Section I.A. and III. for a more in-depth discussion of the these two doctrines.

[90] See Gillian K. Hadfield, "Problematic Relations: Franchising and the Law of Incomplete Contracts" (1990) 42 Stan. L. Rev. 927 where the author relies on the theory to help explain the typical franchise contract, which is an example of a relational contract. This view of relational contracts replaces the classical contract approach and coincides with the growing importance of good faith in contract law: Chapman, *supra*, note 3 at 179 n. 41.

[91] R.R. Drury, "The Relative Nature of a Shareholders Right to Enforce the Company Contract" [1986] C.L.J. 219 at 222; Riley, *supra*, note 16 at 789. Both authors consider intra corporate contracts to be relational contracts. While they are making such

The association of the "incomplete contracting" theory with the "reasonable expectations" test, and the resulting emphasis on certain key features of the test, is both positive and normative in nature. It is positive to the extent that support for these features can be drawn from the case law. Most of the support is, however, implicit in nature and gleaned from an analysis of the current oppression case law taken as a whole. It would be inaccurate to say that each of these features are universally supported by all of the recent oppression cases. The following assessment is therefore normative in that the features identified below are recommended as being integral features of the "reasonable expectations" test. It is also normative to the extent that the association is intended to encourage the courts to explicitly recognize, at a minimum, the "reasonable expectations" test's core features as identified herein. This normative pursuit argues against the current judicial reluctance to extrapolate on these features in any detail. It corresponds, however, with the slow trend towards greater specificity in regards to the oppression remedy's

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statements in reference to English companies which have a contractual constitution, their statements are also applicable to the Canadian corporate environment notwithstanding the different constitutional form. See also Hetherington, *supra*, note 89 at 22, 26-27 who characterizes the typical American close corporation as a long term relational contract and VanDuzer, *supra*, note 33 at 483-84.

[92] Goetz & Scott, *supra*, note 84 at 1091.

[93] Schwartz, *supra*, note 84 at 271 n. 1.

application.[94]

The "incomplete contracting" paradigm provides considerable insight into the structure and content of the "reasonable expectations" test. The theory focuses on the parties' underlying agreement. It also facilitates a deeper understanding of the bargaining process. It helps to explain why oral agreements are not always confined to writing as well as why written agreements may sometimes be invalid. It also explains why important matters may not have been agreed upon at the outset. One reason may be that the parties did not have the requisite foresight. Another possible reason is that the parties deliberately avoided deciding on the issue because they thought it might lead to a bargaining failure. The "incomplete contracting" theory also incorporates several gap filling approaches. The approach which is particularly relevant for the purposes of this thesis is the one which advocates the imposition of both penalty terms and hypothetical bargain (would have wanted) terms, depending on the situation. Where strategic reasons prompt the gap, a penalty term is appropriate. Where transaction costs prompt the gap, the courts should apply a hypothetical bargain (would have wanted) term. All of these aspects of the "incomplete contracting" theory are directly applicable to the "reasonable expectations" test, as is shown in detail *infra*.

2. Focus of the "Reasonable Expectations" Test and the Resulting Broad Inquiry

The "reasonable expectations" cases rarely articulate what is specifically contemplated by the "reasonable expectations" test.[95] A review of the application of the test in the case law confirms that the main intention is to determine the underlying agreement amongst the parties. This pursuit is necessary because the written corporate documentation, such as the corporate constitutional documents, may not accurately reflect the complete inter-shareholder arrangement. In this sense, the "reasonable expectations" inquiry faces a task similar to that of the "incomplete contracting" theory. In both situations, one is required to determine the true arrangement between the parties. The "incomplete contracting" theory, however, more explicitly delineates this goal. The oppression case law should follow the "incomplete contracting" example by expressly recognizing, on a regular basis, that the essence of the "reasonable expectations" inquiry is to determine the underlying agreement(s) amongst the parties. This will serve to focus the "reasonable expectations" test.

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[94] This slow trend is exemplified by the gradual evolution of the "general fairness" test into the "reasonable expectations" test. See *supra*, Chapter Two.

[95] This is similar to the English approach in that the courts "talk rather vaguely of expectations and understandings, without articulating their theoretical basis": Riley, *supra*, note 16 at 795.

Steering the focus towards the true arrangement amongst the parties helps explain the need for the broadly probing nature of the "reasonable expectations" test. This is because one must have regard to all of the circumstances of the situation to determine the true nature of the business relationship. The written documentation, although relevant, is not necessarily determinative. This focus helps to legitimize the often repeated admonition by the courts that each case is very fact dependent. It also draws attention to the fact that the courts are not bound by the strict requirements of traditional contract law when determining the content of the underlying agreement.[96]

The focus of the "reasonable expectations" test and its need for a broad inquiry are better appreciated when the test is considered in association with the "incomplete contracting" theory. These features provide an essential starting point for the test.

3. The Incompleteness of Written Corporate Documentation

Why can a court not simply rely on the constating documents and any formal written corporate agreements to ascertain a complainant's interests? Put another way, why do the more vulnerable parties, such as minority shareholders, not simply contract for protection at the outset by delineating their respective expectations and understandings in writing? The "incomplete contracting" theory identifies several reasons why this generally does not occur.[97] The theory recognizes that intra corporate arrangements are rarely fully articulated in writing. Several of the "incomplete contracting" reasons for this incompleteness are directly applicable to oppression type situations and are detailed *supra*, in Section III.B. of this Chapter Four.[98] Briefly, the reasons are as follows:

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[96] See Chapman, *supra*, note 3 at 187-88. This point, and the process used to determine the content of the agreement, is explained in further detail *infra* in Section III.C.4 of this Chapter Four.

(a) transaction costs (both time and monetary) of detailing the entire arrangement in writing are generally prohibitive;

(b) communication problems may result in a written agreement being unrepresentative of the parties' true agreement;

(c) incomplete foresight leaves the parties unable to anticipate all of the contingencies; and

(d) strategic manoeuvres which result in the exploitation of a more vulnerable party through either the omission or insertion of contract terms may render the relevant agreement, or portion thereof, invalid.

The enabling nature of corporate legislation means that there are many different types of intra corporate arrangements that may arise in a corporation. The complexity and longevity of these arrangements will vary both within a corporation and from one corporation to the next. The transaction costs associated with detailing the entire corporate relationship of all of the parties in writing could, in many cases, be tremendous. Even if one was willing to incur such costs, the parties will generally lack the requisite foresight to anticipate all of the potential contingencies that could arise and set out the respective obligations of each party in the event of such contingency.[99] This is particularly difficult when one considers the long term nature of many corporate relationships. As well, in numerous oppression cases, one party is in a much better strategic position than another party and may be inclined to take advantage of the latter party's vulnerability.[100] Any one or more of these reasons may significantly impede the parties' ability to delineate in writing everyone's respective obligations, commitments and rights.

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[97] F. Hodge O'Neal, "Close Corporations: Existing Legislation and Recommended Reform" (1978) 33 Bus.Law. 873 at 881, 883-87; Hetherington & Dooley, *supra*, note 12 at 2, 36-37. Hetherington and Dooley feel that an overemphasis on contractual terms reflects a "fundamental misunderstanding of the nature of close corporations": Hetherington & Dooley, *supra*, note 12 at 2.

[98] Cheffins, *supra*, note 15 at 802; Cheffins, *supra*, note 86 at 66, 67, 127, 128, 132 (Cheffins states that while these factors impact on both public and closely held corporations, he feels they will have a greater impact on closely held corporations.); Chapman, *supra*, note 3 at 172-73. See Paul L. Davies, *Gower's Principles of Modern Company Law*, 6th ed. (London: Sweet and Maxwell, 1997) at 742-43, a text on English law, where he references transaction costs and the unpredictability of the future as factors which help explain why a corporate relationship may not be entirely set forth in writing. See also Prentice, *supra*, note 32 at 58-59.

Many of these reasons also help explain why written agreements may not reflect the true arrangement amongst the parties.[101] For example, communication problems, an attempt to minimize costs, inaccurate foresight and/or the fact that one party may have exploited the vulnerability of another, may render an agreement somewhat unrepresentative of the parties' true intentions. In such circumstances, enforcing the strict letter of the agreement would not be appropriate. This is not to say that either the "reasonable expectations" inquiry or the "incomplete contracting" concept will readily discount written agreements. On the contrary, both approaches view consensual contracts in high regard, to the extent that they are perceived to reflect the parties' true agreement and are not exploitive of a more vulnerable party.[102] The judicial treatment of shareholder agreements and other written documentation is illustrative in these regards.[103]

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[99] See Hetherington & Dooley, *supra*, note 12 at 36-37. Hetherington and Dooley specifically note:

> Given the limitations of human foresight and knowledge, any attempt to describe the majority's duties and obligations precisely is likely to leave the minority vulnerable to some overlooked form of exploitation, while at the same time, seriously impairing the efficiency of the firm by fettering management: Hetherington & Dooley, *supra*, note 12 at 36-37.

The Institute of Law Research and Reform, now called the Alberta Law Reform Institute, also recognized that "foresight is necessarily imperfect...." This recognition was made in reference to the broad definition of the term "complainant" in oppression and derivative actions. See *Report No. 36: Proposals for a New Alberta Business Corporations Act*, vol. 1 (Edmonton, Institute of Law Research and Reform, 1980) at 150.

[100] O'Neal, *supra*, note 97 at 884.

[101] Cheffins, *supra*, note 15 at 785-86; O'Neal, *ibid.* at 886-87.

In oppression cases, the courts have been reluctant to concisely and deliberately set forth why they must probe beyond the written documentation of the corporation. In the course of the adoption and application of the "reasonable expectations" test, sporadic references have been made by the courts to why the parties often do not, or cannot, contract for protection at the outset. For the most part, however, this is not expanded upon in the decisions. Therefore the courts tend not to explain why it is unreasonable to expect a person to obtain contractual protection.

The "incomplete contracting" theory, in contrast, has conveniently delineated several plausible explanations which are equally applicable in the oppression context. Although there may be additional reasons why one is unlikely to find a complete written agreement that expressly provides for all of the parties' respective rights and obligations, the explanations proffered by the "incomplete contracting" theory provide a solid base.[104] To the extent that these reasons are clearly identified, understood and accepted, one is better able to understand the necessity for, and the legitimacy of, a test that emphasizes the need to consider the parties' relationship and circumstance. This will add further legitimacy to the "reasonable expectations" test and indirectly, to the appropriateness of court intervention through the application of the oppression remedy. Consequently, when applying the "reasonable expectations" test, the Canadian courts should expressly recognize these "incomplete contracting" reasons.

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[102] For the economic position see Cheffins, *ibid.* at 784-85.

[103] See *supra*, Chapter Two, Section II.C.3.c.i.

[104] An additional reason may be the informal and confusing nature of the written documentation: Riley, *supra*, note 16 at 785-86.

4. Determination of the Underlying Agreement - The Construction Process

The common goal of both the "incomplete contracting" theory and the "reasonable expectations" test is the determination of the complete contract between or amongst the parties. The optimum way to view this task is that the courts are required to "construct" the underlying arrangement, the process of which differs from classical contract law analysis.[105] This goal requires a broad inquiry into the circumstances of each case, unconfined by the traditional rules of contractual analysis. Having recognized the main goal and the need for a broad inquiry, it is now necessary to more concretely set forth what methods the courts use to construct the underlying arrangement. The oppression cases usually fail to expressly outline the process(es) used to determine this compact.[106]

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[105] Riley, *ibid.* at 785. As Riley notes, the term "construct" is very appropriate in light of the active role the judiciary must take in effecting this goal: Riley, *ibid.* at 785. The courts must disregard many of the specific rules of contract law when discerning the agreement such as, for example, the parole evidence rule. The courts will also, in some cases, go beyond a strict contractual analysis to impose terms the courts feel are more appropriate, regardless of what the parties' agreement may have been. This latter situation may arise, for example, when the conduct is exploitive or opportunistic to the detriment of the complainant. Riley does not view this as true gap filling because it may override a clear term expressly agreed upon by the parties: Riley, *ibid.* at 789-790, 797. In such cases, Riley feels the courts artificially create a gap so that they can "control the operation of the parties' express terms": Riley, *ibid.* at 797. The "incomplete contracting" theory, however, offers several legitimate reasons why the terms of a written contract should not always govern. In such cases, a gap is left in the contract that the court must fill. See Clifford, Jr. *supra*, note 18 at 53 where, in commenting on the American "reasonable expectations" test, he notes that "reasonable expectations are not confined to contract..."

[106] The *820099 Ontario* Inc. v. *Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at 123 (Ont.Gen.Div.), aff'd (1991), 3 B.L.R. (2d) 113 (Ont.Div.Ct.) case provides the most insight in this regard. J. Farley held that the relevant expectations are those "which could

The "incomplete contracting" theory provides some insight in this regard.

Proponents of the "incomplete contracting" theory suggest several gap filling approaches. Two of which were discussed *supra,* in Section III.B. of this Chapter Four. It is the combination approach to gap filling that provides particular guidance for the application of the "reasonable expectations" test. This gap filling approach advocates the use of both a hypothetical bargain approach and a penalty approach, depending on the circumstances.[107] The hypothetical bargain approach represents what the parties "would have" agreed to. The penalty approach imposes what the parties "should have" agreed to.

The general approach used by the courts in the second stage oppression cases could be viewed as being gap filling in nature. The gap filling done in oppression cases most closely resembles the "incomplete contracting" theory's combination approach to gap filling. This resemblance is obvious when one examines the various methods used in oppression cases to discern the parties' "reasonable expectations," and accordingly, their underlying agreement. These methods are as follows:

(a) what the parties *have* agreed to as evidenced by written contractual documentation;

(b) what the parties *would have* agreed to, had it been set out in writing; and/or

(c) what the parties *should have* agreed to.

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be said to have been (or ought to have been considered as) part of the compact of the shareholders": *Ballard, supra*, at 186). This statement was subsequently adopted by several cases including *Naneff* v. *Con-Crete Holdings Ltd.* (1995), 23 O.R.(3d) 481, 23 B.L.R.(2d) 286 (Ont.C.A.) and *Themadel Foundation* v. *Third Canadian Investment Trust Ltd.* [1998] O.J. No. 647 (C.A.).

[107] See *supra*, notes 71 - 78 for a discussion of this "incomplete contracting" approach to gap filling. In some cases, the same term will result from a consideration of both the hypothetical bargain and penalty approaches. Thus, what the parties would have agreed to with full information and no transaction costs may often resemble what the courts feel the parties should have agreed to. Therefore, in the end result, the distinction will, in some cases, be artificial.

The distinction between each of these methods is difficult to make in the abstract. The following discussion examines each method in more detail.

The first method focuses on what the parties "have" agreed to, from a contract law perspective. The types of cases that fall within this category are only those where the point in issue is expressly addressed in a contractually binding document. These contractual terms then form the basis of the parties' reasonable expectations. This method is technically not gap filling because it is merely enforcing what the parties have actually agreed to. It is, however, consistent with the "incomplete contracting" approach in the sense that prior to enforcing the written terms, the courts will consider the circumstances of the case to ascertain whether the agreement appropriately reflects the parties' agreement.

The *Lyall* v. *147250 Canada Ltd.* case[108] adopted this method. In this case, the unanimous shareholder agreement provided that the unanimous consent of the shareholders was required for any transaction outside of the ordinary course of business. The conduct in question was outside of the ordinary course, however the defendants did not obtain the consent of the plaintiff shareholder. The court held that the violation of the shareholder agreement was contrary to the plaintiff's reasonable expectations. It was considered reasonable for the plaintiff to expect that the parties would comply with the agreement.

The *GATX Corp.* v. *Hawker Siddeley Canada Inc.* case[109] is another example. In this case, the defendant entered into a series of transactions that, as a whole, triggered the right of first refusal agreement the parties had entered into. The defendant's failure to comply with the terms of the right of first refusal constituted a violation of the plaintiff's legitimate expectation that the parties would comply with the agreement.

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[108] (1993), 106 D.L.R.(4th) 304, 12 B.L.R.(2d) 161 (B.C.C.A.).

[109] (1996), 27 B.L.R.(2d) 251 (Ont.Gen.Div.).

There are not many oppression cases that solely use this first method. Often the court will supplement the written documentation with additional terms and thus launch it into the second method.

The second method focuses on what the parties "would have" agreed to, had it been set forth in writing. It includes, at a minimum, the following situations:

(a) where the parties have orally agreed on a matter, yet have not set it out in writing;

(b) where there is a written contract that is relevant to the issue, yet it does not represent the parties' complete agreement on the issue;[110]

(c) where the parties have not previously considered the issue in question.

The "would have" judicial method definitely involves gap filling as the court is supplementing the terms of any written agreements and the constating documents with its findings. Some of these cases make findings that represent what the parties have orally agreed to. If the terms are not set out in a written agreement, the court is using the "would have" method, as categorized herein, and thus is gap filling. Other cases that use this method may involve situations where the parties did not even consider the particular contingency. The courts' determinations in these circumstances amount to gap filling since there is no contract directly on point.

Several case law examples help to illustrate this method. In *Themadel Foundation* v.

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[110] For example, in *Deluce Holdings Inc.* v. *Air Canada* (1992), 98 D.L.R.(4th) 509, 8 B.L.R.(2d) 294 (Ont.Gen.Div.), there was a unanimous shareholder agreement which allowed a shareholder's shares to be bought if the shareholder was discharged from his employment with the corporation. The court supplemented this right to call by restricting it to only those situations where the termination was in the best interests of the corporation. The court felt that this restriction more aptly represented the parties' arrangement.

Third Canadian Investment Trust Ltd.,[111] the court relied on representations made in an information circular and in press releases as the basis for the applicants' reasonable expectations. Although the documentation was not contractually binding on the respondents, it was sufficient to justify the applicant's reasonable expectations. The documentation provided evidence as to what the parties would have agreed to, had there been a written agreement on the subject.

The *Ballard* case is another example. In *820099 Ontario Inc.* v. *Harold E. Ballard Ltd.*,[112] the applicant, who was a director for many years, was discharged from his office as a director. Notwithstanding that there was no written agreement guaranteeing the applicant continued status as a director, the court found that, based on his years of continued service and other factors, it would be reasonable for the applicant to expect that he would continue as director unless he was guilty of misconduct. In another case, *Three Point Oils Ltd.* v. *Glencrest Energy Ltd.*,[113] the applicant was excluded from management yet there was no written contract guaranteeing the applicant's participation in management. In assessing what the parties' expectations were, the court considered the circumstances of the case, including whether there was a pre-existing partnership structure and the content of any relevant agreements. The intention, again, was to discern what the parties would have agreed to had they set it out in writing.[114]

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[111] [1998] O.J. No. 647 (C.A.).

[112] (1991), 3 B.L.R.(2d) 113 at 123 (Ont.Gen.Div.), aff'd (1991), 3 B.L.R.(2d) 113 (Ont.Div.Ct.).

[113] (1997), 5 Alta.L.R.(3d) 140 (C.A.).

[114] Most of the cases fall within the "would have" category since the oppression cases usually involve a situation where the parties' respective rights, interests and obligations have not been completely set forth in a written contract. The following are additional examples:

a. In *Gordon Glaves Holdings Ltd.* v. *Care Corp. of Canada* [1998] O.J. No. 801, the corporation received life insurance proceeds pursuant to the death of the principal of the applicant shareholder. These proceeds were distributed amongst

Most of the oppression cases use the "would have" method. This method echoes the "incomplete contracting" theory's "hypothetical bargain" approach to gap filling. For this method, the court's goal is to determine what the parties would have agreed to, having regard to the entire circumstances of the case, including the parties' relationships as well as applicable corporate norms.

The third method has regard to what the parties "should have" agreed to, regardless of what they have, or would have, agreed to. These cases involve unlawful conduct that amounts to a misappropriation of corporate assets or opportunities to the detriment of a more vulnerable party. Therefore even if the applicant consented to the conduct in writing, the court may still find it to be oppressive because it is not what the applicant "should have" agreed to. This third method echoes the "penalty" approach to gap filling advocated by several "incomplete contracting" theorists.

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the shareholders, yet no purchase of the deceased shareholder's shares followed. An oppression action was brought based on the failure of the corporation and the other shareholders to buy the said shares. The court found that it would have been reasonable to expect, in the circumstances, that the corporation, or the other shareholders, would buy out a deceased shareholders' shares with the insurance proceeds.

b. In *Westfair Foods Ltd.* v. *Watt* (1991), 79 Alta.L.R.(2d) 363, 5 B.L.R.(2d) 160 (C.A.), leave to appeal to the S.C.C. refused 101 D.L.R.(4th) viii., 141 A.R. 317*n*. the constating documents provided that the applicants were preferred shareholders that were entitled to a preferred dividend as well as a right to share equally with the common shareholders upon dissolution. There was no term in the constating or in any written agreements that dealt with retained earnings. The applicants brought an oppression action claiming that the respondents new dividend policy, which distributed all of the retained earnings to the common shareholders, was oppressive. The court held that, although it was inconsistent with previous practice, the new dividend policy was not oppressive since the parties never intended that the applicant shareholders would also be able to share in the surplus earnings.

See also *Lee* v. *To* [1998] S.J. No. 347 (C.A.); *Ludlow* v. *McMillan* [1995] 6 W.W.R. 761, 19 B.L.R. (2d) 102 (B.C.S.C.); *Naneff* v. *Con-Crete Holdings Ltd.*, *supra*, note 106.

The *Neri* v. *Finch Hardware (1976) Ltd.* case[115] illustrates this third approach. In this case, the majority shareholders and directors of a corporation put themselves in a conflict of interest position by purchasing a new business that should have been purchased by the corporation. The applicant shareholder and employee was well informed of the impugned conduct and was invited to participate. The applicant declined, yet he did not expressly object to the others proceeding with the purchase. It was only after the applicant was dismissed from employment and unable to sell his shares that he brought an oppression application. The court held that the impugned conduct was oppressive, notwithstanding the applicant's failure to oppose the conduct at the outset. Therefore the court was not applying what the parties' have, or would have, agreed to. Instead they were guided by what the parties should have agreed to. The *Chiaramonte* v. *World Wide Importing Ltd.* case[116] is a similar example.

Some argue that this third approach does not always involve gap filling because, in some cases, the courts decision may override the express agreement of the parties.[117] This third method, however, could still be considered a gap filling technique. The "incomplete contracting" theory provides several reasons why, in some cases, certain terms of a written agreement should not govern. For this third method, the applicable reason for the invalidity would be based on the strategic manipulation of a more vulnerable party. The resulting exploitive term would be considered invalid, which thereby leaves a gap for the courts to fill. This method operates to protect the more vulnerable parties and thereby control the resulting arrangement. This third method is used less frequently than the "would have" method, however it is still important.

Characterizing the oppression cases as being gap filling in the "incomplete contracting" sense allows for a more comprehensive understanding of the judicial methods used in oppression cases to ascertain the underlying agreement. First, it emphasizes that the inquiry is not purely contractual. In some cases, the contractual terms, in a contract law sense, will govern. In most cases, however, the judicial inquiry will be much broader. It will be guided by the parties' intentions as evidenced by their past and present words, agreements and conduct, placed in the context of the circumstances of the case and the relationships of the parties. In still other, more rare, cases, the courts will consider what the parties' should have agreed to, having regard to the strategic vulnerability of one party as against another party. To date, there has been little express comment in the cases on this subject, and nothing even remotely close to a universal recognition of these various methods used to create the parties' compact.

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[115] (1995), 20 B.L.R. (2d) 216 (Ont.Gen.Div.).

[116] (1996), 28 O.R. (3d) 641 (Gen.Div.).

[117] Riley, *supra*, note 16 at 789-90, 797.

This categorization also provides direction in the oppression cases as to which method a court should use in a particular circumstance. It is relatively clear that the court will apply what the parties "have" agreed to, as set forth in a written contract, if it accurately reflects the parties agreement and is not exploitive. It is less clear when the court will use the "would have" and "should have" methods.

The "incomplete contracting" theory's combination approach to gap filling, proposed by Ayres and Gertner, assists in this regard. It provides that the courts should be sensitive to the reason for the gap when determining which method to use.[118] If the reason for the gap is related to transaction costs or lack of foresight, then the courts should impose what the parties "would have" agreed to.[119] Finally, if the reason for the gap is due to the term being exploitive or opportunistic in nature to the detriment of a more vulnerable party, then the court should impose what it feels the parties "should have" agreed to.[120]

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[118] See *supra*, notes 76-78 and accompanying text. In numerous cases, the same contractual term may result regardless of which method the courts use. A more general example is a term which imports a fiduciary duty: Hadfield, *supra*, note 45 at 149-150.

[119] Campion *et al* note that the typical corporate norms are more likely to form the basis of a reasonable expectation (and therefore be used as gap fillers) for public corporations: Campion, Brown & Crawley, *supra*, note 6 at 250. These types of gap fillers are more likely to coincide with what the parties "have" or "would have" agreed to.

The "incomplete contracting" theory therefore requires one to examine the circumstances of the case and the relationships of the parties in order to determine the reason for the gap. This is consistent with the repeated direction in the oppression cases that one must always have regard to the relationship and circumstance of the parties.

In summary, the "incomplete contracting" theory helps illustrate that the application of the "reasonable expectations" test involves some measure of gap filling. The goal of the test is to discern the parties' agreement. Generally only a portion of the parties' agreement will be set forth in writing and even that portion may not be representative of the parties' agreement. The courts are therefore faced with the task of determining the complete agreement.

Although the expectations inquiry has contractual elements, the judicial methods used in the oppression cases are not based solely on contract law.[121] The test is contractually driven in the sense that its ultimate goal is to determine the parties' agreement. As well, the courts will pay high regard to what the parties have actually agreed to when assessing the content of this agreement. The courts, however, are not bound by the traditional rules of contract law when making this assessment.[122] As well, many of the cases that fall within the "would have" and "should have" construction methods are quite distinct from an approach based on contract law. Many of the cases that apply the "would have" (hypothetical bargain) method are basing the terms on hypothetical, not real, bargains.[123] The "should have" (penalty) method is even more removed from contract law as it has no regard for the parties agreement, whether real or hypothetical.

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[120] Cases involving the misappropriation of corporate assets support the imposition of terms based on what the parties "should have" agreed to. In some of these cases, the complainant was aware of the conduct and either consented to it or was invited to participate. The courts, however, still found the conduct to be oppressive. See *Neri* v. *Finch Hardware (1976) Ltd.*, *supra*, note 115 and *Chiaramonte* v. *World Wide Importing Ltd.*, *supra*, note 116.

[121] This assessment is consistent with the interpretation by several American academics of the American approach. See Clifford, Jr. *supra*, note 18 at 53 where, in commenting on the American "reasonable expectations" test, he notes that "reasonable expectations are not confined to contract, nor, ...are they static."

5. The "Reasonable Expectations" Criteria

The "reasonable expectations" criteria fit nicely within the "incomplete contracting" theory's gap filling framework. These criteria support the proposition that the oppression courts use different gap filling methods to discern the parties' agreement as they provide varying degrees of insight on the different methods.

The relevance of the criteria will depend, in part, on the gap filling method being used by the court. Written documentation will be most useful for the "have" and "would have" methods. Foreseeability of the conduct, the business judgment rule and the type of corporation will provide the most insight into the "would have" method. The misappropriation of corporate assets or opportunities triggers the "should have" method. The courts may have regard to any of the prominent criteria to assess the appropriate gap filler in the "should have" circumstances.

6. Criticisms

It is now appropriate to consider, and defend against, several potential criticisms of incorporating economic theory into an analysis of the Canadian oppression remedy's

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[122] Chapman, *supra*, note 3 at 187-88.

[123] This does not apply to the "would have" cases that simply involve the court enforcing the parties' oral agreement.

"reasonable expectations" test.[124]

a. Criticism: *The "incomplete contracting" theory is not sufficiently precise to be called a theory in its own right.*

The assumptions and principles of the economic theory of "incomplete contracting" are not unanimously agreed upon. The theory is still developing and will continue to develop as its potential applicability is more fully realized. The fact that one cannot readily point to a concise and concrete group of universally agreed upon principles and assumptions does not render the theory useless. Although still developing, the "incomplete contracting" theory can provide considerable insight into the application of the "reasonable expectations" test.

b. Criticism: *An economic analysis which advocates a contractual approach is not appropriate for the corporate form currently popular in Canada.*

Some may consider the corporate form which uses a memorandum and articles of association structure to be more consistent with a contractual approach due to the legislative provision which deems the constating documents to be contractual in nature.[125] This form was more popular in Canada prior to the statutory reforms commencing in the 1970s.[126] The incorporation legislation currently popular in Canada contains no such deeming provision. The author does not consider the lack of such a deeming provision to be critically important for several reasons.

First, the contractual status sprang from legislation, not from the unique attributes of the constating documents.[127] Second, the companies that are subject to the deeming contractual provision are not governed by the typical rules of contract.[128] Accordingly, there are major differences between the treatment of statutory company contracts and regular contracts.[129] The legal treatment of statutory contracts more closely resembles the legislative and judicial approach to the corporate form currently popular in Canada. Therefore statutory provisions that deem company documentation to have contractual status are somewhat artificial since they do not create a true contract situation.

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[124] For additional criticisms of the economic approach to law see Cheffins, *supra*, note 15 at 787-88. It is both unnecessary and beyond the scope of this thesis to analyse these criticisms in further detail.

[125] Welling, for example, seems to be of this viewpoint. See Welling, *supra*, note 34 at 548 n. 285.

[126] The corporate statutes in British Columbia and Nova Scotia still use this form.

Third, it is an economic, not a legal, theory that is advocating the contractual approach. While there may be some overlap in the meaning of the term "contract," the term's meaning in each discipline is not identical. The absence of a deeming contractual provision in the legislation is consequently not determinative because it involves the legal, not economic, discipline.

Fourth, the power and undisputed importance of the unanimous shareholder agreement in the current corporate form directly reflects the influence and relevance of contract in the corporate realm.[130] In Canada, this power derives primarily from a legislative base.[131] Support for the importance of contract in the current corporate form does not only derive from legislation. Judicial support for its relevance can also be gleaned from an analysis of the application of the oppression remedy. That is, the oppression cases definitely consider agreements between the parties to be relevant to the extent that they reflect the true intentions of the parties. Finally, contract law is sometimes considered the area of law closest to corporate law.[132] It is therefore conceivable that they will have overlapping characteristics.

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[127] The legislation deemed the documentation to constitute a contract between and amongst the shareholders and the company.

[128] Vivien R. Goldwasser outlines several ways in which the statutory contract is treated differently from a regular contract. Some of the rules applicable to regular contracts which differ from statutory contracts are as follows: only parties to the contract are bound by it; one needs the consent of all of the parties to amend it, not simply a significant majority; the remedy granted for a breach are generally damages, not injunctions or declarations mandating compliance with the articles and memorandum of association: Vivien R. Goldwasser, "Shareholder Agreements-Potent Protection for Minorities in Closely Held Corporations" (1994) 22 Aust. Bus. L.R. 265 at 267.

[129] Goldwasser, *ibid.* at 268.

Thus, the fact that most of the corporate legislation in Canada does not include a deeming contractual provision in relation to the constating documentation does not render contractual economic analysis irrelevant to an analysis of current corporate law.

c. Criticism: *Pure contractual economic analysis does not favour mandatory terms. The oppression remedy, however, is mandatory legislation.*

First, mainstream contractarians recognize that contracts may sometimes fail in corporate law which opens the door for mandatory legislation.[133] Although there remains a presumption against regulation,[134] it is well understood that mandatory legislation is needed in some areas.[135]

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[130] Hetherington, *supra*, note 89 at 29-30.

[131] For example, see *CBCA*, s. 146(2). In a unanimous shareholder agreement, one can shift some or all of the directors' powers, and consequent duties, to the shareholders.

[132] See *supra*, note 23.

[133] Bratton, *supra*, note 21 at 188-89, 194-95.

[134] Bratton, *ibid.* at 197, 207.

[135] Even strong contractarians, such as Easterbrook and Fischel, appreciate the need for some mandatory regulation. This is because a pure contractual analysis cannot provide all of the answers. See Bratton, *ibid.* at 194-95 & 194 n. 88. See also B. Chapman, *supra*, note 22 at 147-48.

Second, the "incomplete contracting" theory's endorsement of penalty gap fillers suggests that the theory goes beyond a simple contractual assessment since penalty gap fillers do not reflect what the parties agreement would have been. They are therefore consistent with the notion of mandatory legislation. Third, for the same reasons why it is unlikely that a vulnerable party will be able to protect itself with a written contract at the outset, it is unreasonable to expect that the oppression remedy will adequately meet its objective if it is only a default term.[136] The oppression remedy's mandate is essentially to ensure fair conduct. Any provision excluding such a term would certainly raise questions as to whether it truly reflects the parties' agreement.[137]

Finally, although the remedy is mandatory, the heavy weight accorded agreements which legitimately reflect the parties' intentions render its mandatory nature somewhat illusory. The remedy's open-ended wording allows courts sufficient flexibility in application to account for such agreements, where appropriate.[138]

7. Summary

The "incomplete contracting" theory provides considerable insight into the structure and content of the "reasonable expectations" test. In this way, it provides a firm theoretical foundation to both the "reasonable expectations" test and the oppression remedy.

More specifically, the economic theory helps focus the goal of the "reasonable expectations" test. This goal is to discern the underlying arrangement between the relevant parties. Second, the "incomplete contracting" theory helps explain why it is unrealistic to expect that the intra corporate arrangement will be entirely and accurately set out in writing. This may be due to imperfect communication, unequal bargaining positions, unforeseen contingencies and/or transaction costs. The courts in oppression cases are therefore forced to "construct" the true arrangement, which is, in essence, gap filling. Written bargains will often, however, be of some assistance, to the extent that they accurately reflect the parties' agreement.

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[136] See Bratton, *ibid.* at 194 who notes that for open-ended obligations, such as fiduciary duties, contract failure is probable. The oppression remedy would fall within the realm of open-ended remedies.

[137] Riley, *supra*, note 16 at 797.

[138] VanDuzer, *supra*, note 33 at 480.

Third, the "hypothetical bargain" and "penalty" gap filling techniques, advocated by several "incomplete contracting" theorists, are also used in oppression cases. The courts will sometimes use either or both of these methods to assist in the construction of the underlying agreement pursuant to the "reasonable expectations" test. In some cases, the courts will apply what the parties would have agreed to, had they set it out in writing. This method represents the "hypothetical bargain" gap filling approach. It is the most common method and generally applies where the transaction costs, imperfect communication or lack of foresight cause the expectations not to be set forth in writing. In other cases, the court will impose a term it feels is appropriate, regardless of whether the parties would have agreed to it. This method represents the "penalty" gap filling approach. In these types of situations, the courts are essentially imposing the term they feel the parties should have agreed to in the circumstances. This approach takes on particular significance when the conduct is exploitive or opportunistic of a more vulnerable party. Of course, there will also be cases where the courts will apply what the parties have actually agreed to, based on a written contract to that effect. This last type of situation technically does not involve gap filling and thus does not involve either of the above referenced gap filling techniques.

The "incomplete contracting" theory not only helps to clarify several of the gap filling methods used in oppression cases, it also provides general guidance as to when the different methods should be used. The "would have" method is to be used if the reason for the gap is lack of foresight, imperfect communication or transaction costs. The "should have" method is to be used where the strategic inequities between the parties are exploited to the detriment of a more vulnerable party.

There is very little express judicial comment in the oppression cases which support the features of the "reasonable expectations" test summarized *supra*. The support is generally implicit in that it is gleaned from a review of the actual application of the test and/or the oppression remedy. Thus, the analysis in this Chapter Four is normative in the sense that the author is recommending that the courts expressly adopt these elements as integral components of the oppression remedy's "reasonable expectations" test.

CONCLUSION

The importance of the oppression remedy in the Canadian corporate landscape is difficult to overstate. The remedy's enactment in the *CBCA* was a marked departure from the judicial tradition of non-interference in corporate matters. It signified a long awaited advance in the protection of the rights and interests of minority shareholders. Although the remedy is not restricted to minority shareholders, the alleviation of their plight served as a primary motivation.[1] The oppression remedy applies to public and closely held corporations. It will have the most impact on closely held corporations and on public corporations that have a dominant shareholder and illiquid share holdings.[2]

The open ended wording of the oppression remedy requires the judiciary to define its application parameters. While the remedy's three grounds of unfair prejudice, unfair disregard and oppression have long been held to impose a standard of fairness, the courts have been reluctant to further define its ambit.[3] A clear articulation of the oppression remedy's ambit is essential due to the sweeping nature of the remedy.

The growing acceptance of the "reasonable expectations" test as the oppression remedy's governing test assists in this pursuit.[4] This test requires a court to focus on the complainant's "reasonable expectations" when assessing whether oppression, in the broad sense, has occurred.[5] Unfortunately, there is little judicial guidance to identify what the test entails. Many of the cases simply emphasize that the inquiry is fact dependent and that one must have regard to the entire circumstances of the case, including the inter-shareholder relationships. Accordingly, the courts caution against drawing general principles from cases that do not involve identical facts. The United States also uses a "reasonable expectations" inquiry in many oppression cases to help determine whether oppression has occurred. Although the United States had adopted the test prior to Canada, they are not much further ahead in identifying its content and theoretical structure.[6]

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[1] See *supra*, Chapter One for further background on the oppression remedy.

[2] See *supra*, Chapter Two, Section I. which describes closely held corporations as well as two types of public corporations.

[3] See *supra*, Chapter Two, Section II.B. for information on the "general fairness" test. As noted by Peterson, the oppression remedy is not well developed: Dennis H. Peterson, *Shareholder Remedies in Canada* (Toronto: Butterworths, 1989, updated to 1998) at 18.1.

[4] See *supra*, Chapter Two, Section II.C. for information on the "reasonable expectations" test.

The "reasonable expectations" test is necessarily broad to ensure its application accords with its purpose. Its broad formulation and context dependent inquiry is not only appropriate, but necessary, in light of the unlimited number of governance, remuneration and share holding structures that a corporation may implement. The test therefore allows sufficient discretion to ensure oppression is found in the appropriate circumstances. At the same time, the test must also provide a certain amount of direction in application. Standing alone, the "reasonable expectations" test provides little guidance to the application of the oppression remedy.[7] The use of the "reasonable expectations" test in both Canada and the United States confirms that the test's potential is recognized. The lack of express direction as to the structure and content of the "reasonable expectations" test, however, could significantly undermine its effectiveness.

The "reasonable expectations" test is capable of more precise articulation. In order to glean more insight into, and direction for, the structure and content of the "reasonable expectations" test, one should:

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[5] Oppression "in the broad sense" includes any of the oppression remedy's three grounds of unfair prejudice, unfair disregard or oppression.

[6] See *supra*, Chapter Three for information on the American approaches to minority shareholder protection.

[7] See the quotation set out *supra* at the beginning of this thesis, prior to Chapter One.

(a) review the application of both the "reasonable expectations" test and the oppression remedy in the case law; and

(b) consider the economic theory of "incomplete contracting" in the context of the oppression remedy.

With respect to the case law application, a review suggests, implicitly in most cases, that the "reasonable expectations" test focuses on the underlying agreement between the parties. To discern the underlying agreement, it is clear that the court is not confined to contract law principles. Instead, the inquiry is much broader as it considers the entire circumstances of a case against the backdrop of applicable and well-accepted corporate norms. More specifically, there are five factors or elements that are particularly relevant when pursuing a "reasonable expectations" inquiry. These factors are:

(a) consider the content of any relevant written documentation, whether in agreement form or otherwise;

(b) consider whether the conduct was foreseeable such that one would reasonably expect it to occur;

(c) consider whether there was a misappropriation of assets or opportunities;

(d) consider the business judgment rule which serves as a reminder that one must balance the often competing, but legitimate, interests of the various participants when applying the oppression remedy; and

(e) consider whether the corporation is a widely held public corporation with liquid share holdings, in respect of which an oppression claim is far less likely to arise; as compared with a public corporation that has a dominant shareholder and illiquid share holdings or with a closely held corporation.

None of these factors are conclusive and they may suggest opposite results with respect to the applicability of the oppression remedy. Most cases will involve a balancing of two or more of these factors.

The foregoing results provide substance to the "reasonable expectations" test, yet they are generally not based on express judicial commentary. Instead, they are gleaned from an analysis of the case law application of both the "reasonable expectations" test and the remedy. The judiciary must be encouraged to expressly recognize and discuss these and additional principles that are being used to guide the remedy's application. It is to this end that the economic theory of "incomplete contracting" can provide considerable assistance.

The study of economics and the law is becoming increasingly relevant to corporate law. The economic theory of "incomplete contracting" provides critical insight into the structure and content of the "reasonable expectations" test.[8] It focuses on the potential, and sometimes inevitable, incompleteness of many written contracts and facilitates a deeper understanding of the bargaining process.

The "incomplete contracting" theory offers several explanations as to why contracts are likely to be incomplete. More specifically, transaction costs, imperfect communication, incomplete foresight and unequal bargaining positions help explain why written corporate documentation will not reflect all of the legitimate rights and interests of each of the shareholders. They also reveal why a written contract may not always be determinative. For example, the written contract may not accurately portray the parties' agreement. As well, it may amount to an exploitation of a shareholder who is in a more vulnerable position. Each of these explanations are equally applicable in the oppression context.

As well, the goal of the "incomplete contracting" theory is similar to the "reasonable expectations" test. Both are attempting to discern the complete agreement between the parties. In oppression cases, actual written evidence of an agreement will be given heavy weight to the extent it is viewed as being an accurate reflection of the parties' true agreement. However, if there is not a definitive written agreement directly on point or if the written agreement is opportunistic in nature so as to render it invalid, the court is required to fill in the gaps of the written contract to discern the parties' underlying compact. The gap filling methods used in oppression cases to complete the agreement are similar to those advocated by several "incomplete contracting" theorists. Both the economic theory and the oppression test recognize that, in many cases, the courts will (and should) fill the gaps by applying what the parties "would have" agreed to. The economic theory provides that this rule should be applied when the reason for the gap is largely due to transaction costs or incomplete foresight. In other cases, generally those where exploitation of a more vulnerable party is a concern, the courts will apply what the parties "should have" agreed to, regardless of what the parties "have" or "would have" agreed to. Each of the five factors enumerated *supra* help to identify, in differing degrees, what the parties' have, would have or should have agreed to.

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[8] See *supra*, Chapter Four for a more comprehensive review of the economic theory of "incomplete contracting."

The foregoing components of the "reasonable expectations" test are easily explained and legitimized within the context of the economic theory of "incomplete contracting." The theoretical structure of the test is enhanced by this economic theory as a result of the latter's emphasis on the focus of the inquiry, the reasons prompting the inquiry as well as the general gap filling measures to apply in order to determine the parties' true compact.

The substantive content of the "reasonable expectations" test identified herein must be expressly identified by the judiciary to preserve and enhance the integrity and usefulness of the test. The test *is* capable of more precise articulation than is currently being offered by the courts. It is hoped that an appreciation of the "incomplete contracting" theory will encourage a more structured application of the "reasonable expectations" test. The economic theory of "incomplete contracting" draws attention to, and helps to legitimize, principles that are essentially only recognized implicitly by the courts. The "incomplete contracting" theory thereby facilitates the development of a more comprehensive and discernable structure for the "reasonable expectations" test. It remains to be seen whether the courts will follow this lead.

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